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THE BANALITY OF FRAUD: RE-SITUATING THE INSIDE COUNSEL AS GATEKEEPER*

*Sung Hui Kim***

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* This title is adapted from Hannah Arendt, *Eichmann in Jerusalem: A Report on the Banality of Evil* (Revised and Enlarged ed., Penguin Books 1994) (1963).

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White-collar offenders are generally better educated and more sophisticated than most criminals. They commit their crimes not in a fit of passion, but with cold, careful calculation. Accordingly, they are the most rational offenders and are more likely than most to weigh the risks of possible courses of action against the anticipated rewards of criminal behavior.¹

A situation exerts an important press on the individual . . . [I]t is not so much the kind of person a man is, as the kind of situation in which he is placed, that determines his action.²

INTRODUCTION

One thing we learned from the recent wave of corporate scandals is that lawyers behaved badly.³ More specifically, inside lawyers⁴ behaved badly.

1. *Penalties for White Collar Offenses: Are We Really Getting Tough on Crime? Hearing Before the S. Subcomm. On Crime and Drugs of the Comm. on the Judiciary*, 107th Cong. (2002) (statement of the Honorable James B. Cormey, Jr., United States Attorney, Southern District of New York), available at http://judiciary.senate.gov/testimony.cfm?id=280&wit_id=650.

2. Stanley Milgram, *Some Conditions of Obedience and Disobedience to Authority*, 18 Hum. Rel. 57, 72 (1965).

3. See, e.g., Final Report of Neal Batson, Court-Appointed Examiner, app. C, at 1, *In re Enron Corp.*, No. 01-16034 (Bankr. S.D.N.Y. Nov. 4, 2003) Role of Enron's Attorneys), available at <http://www.enron.com/corp/por/examinerfinal.html> [hereinafter Batson Report Appendix C] ("[T]here is sufficient evidence from which a fact-finder could conclude that certain of Enron's attorneys involved in its [special purpose entity] transactions (i) committed legal malpractice based on Texas Rule 1.12, (ii) committed legal malpractice based on negligence or (iii) aided and abetted the Enron officers' breaches of fiduciary duty."); Stephen M. Cutler, Div. of Enforcement, U.S. Sec. & Exch. Comm'n, Remarks at the University of Michigan Law School (Nov. 1, 2002), available at <http://www.sec.gov/news/speech/spch604.htm> ("Yet, as of late, many inadequate or even fraudulent disclosure documents have reached the public, almost certainly after having been scrutinized by experienced corporate counsel.").

Bankruptcy Examiner Neal Batson's Final Report on Enron's collapse depicts an uninformed, hands-off, delegating, and detached Chief Legal Officer: Enron's General Counsel James Derrick "rarely provided legal advice to Enron's Board even when significant issues . . . came to his attention" and when he did advise the Enron Board, he "failed to educate himself adequately on the underlying facts or the applicable law to enable him to carry out his responsibilities as legal advisor."⁵ But Derrick, and his legal department,⁶ are not alone. The list of ethically challenged inside attorneys include those at Arthur Andersen, Tyco, Rite Aid, Symbol Technologies, Inso, Warnaco, Gemstar-TV Guide, Computer Associates International, and Google.⁷

Recognizing that many of these lawyers facilitated illegal transactions or failed to act to protect the organizational client, Congress passed a statute singling out inside counsel, for the first time in U.S. history, for special treatment in the fight against securities fraud. It enacted section 307 of the Sarbanes-Oxley Act of 2002,⁸ which—among other things—designates the Chief Legal Officer ("CLO") as one of two primary recipients of a report of "evidence of material violation" with special responsibilities for handling

4. I use the term "inside lawyers," "inside counsel," and "inside attorneys" interchangeably to describe lawyers who work in corporate law departments for corporations. Other commonly used terms include "in-house counsel," "house counsel," or "corporate counsel."

5. Batson Report Appendix C, *supra* note 3, at 190.

6. *Id.* at 190-202 (analyzing the role of Enron's inside attorneys).

7. See Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, In the Matter of Google, Inc. and David C. Drummond, Securities Act Release No. 8523, 84 SEC Docket 2293 (Jan. 13, 2005), *available at* <http://www.sec.gov/litigation/admin/33-8523.htm>; SEC v. Computer Assocs. Int'l, Inc., Litigation Release No. 18,891, 83 SEC Docket 2462 (Sept. 22, 2004), *available at* <http://www.sec.gov/litigation/litleases/lr18891.htm> (Computer Associates International); SEC Charges Symbol Technologies, Inc. and 11 Former Symbol Executives with Securities Fraud, SEC Litigation Release No. 18,734, 82 SEC Docket 3424 (June 3, 2004), *available at* <http://www.sec.gov/litigation/litleases/lr18734.htm> (Symbol Technologies); SEC Sues Three Additional Former Senior Executives of Gemstar-TV Guide for Their Part in Financial Fraud, Litigation Release No. 18,530, 81 SEC Docket 3236 (Jan. 5, 2004), *available at* <http://www.sec.gov/news/press/2004-1.htm> (Gemstar-TV Guide); Complaint, Sec. & Exch. Comm'n v. Kozlowski, No. 02 Civ. 7312 (S.D.N.Y. Sept. 11, 2002), *available at* <http://www.sec.gov/litigation/complaints/compl17722.htm> (Tyco); Complaint, Sec. & Exch. Comm'n v. Bergonzi, No. 1:CV02-1084 (M.D. Penn. June 21, 2002), *available at* <http://sec.gov/litigation/complaints/compl17577.htm> (Rite Aid); Complaint, Sec. & Exch. Comm'n v. Hill, No. 02-CV-11244 (D. Mass. June 21, 2002), *available at* <http://www.sec.gov/litigation/complaints/compl17578b.htm> (Inso); Amon Burton & John S. Dzienkowski, *Reexamining the Role of In-House Lawyers After the Conviction of Arthur Andersen*, in *Enron: Corporate Fiascos and Their Implications* 689, 692-711 (Nancy B. Rapoport & Bala G. Dharan eds., 2004); Press Release, Sec. & Exch. Comm'n, SEC Announces Settlement with Warnaco, Former Warnaco Executives, and PwC for Financial Disclosure Violations (May 11, 2004), *available at* <http://www.sec.gov/news/press/2004-62.htm> (Warnaco).

8. Pub. L. No. 107-204, § 307, 116 Stat. 745, 784 (codified as amended at 15 U.S.C. § 7245 (Supp. II 2002)).

such reports.⁹ Convinced that lawyers had too eagerly accommodated managerial misconduct¹⁰ and that inside counsel are in a superior position to interdict corporate fraud, Congress essentially deputized a public corporation's CLO as a gatekeeper of our national securities markets.¹¹

While Congress sought to resolve the problem of lawyer acquiescence in fraud, the provision's impact will probably be limited. Implicit in the reform is the assumption that any breakdown in ethics is rooted in the explicit tradeoffs between morality and greed; that ethical infractions are conscious, rational, and intentional; that it is simply a matter of deliberate choice.¹² This assumption is evidenced by the overwhelming reliance on explicit moral commandments, backed by the threat of ex post disciplinary or civil sanctions in the hopes of altering the lawyer's cost-benefit analysis. While this "venality hypothesis"¹³ may well be true of the few known

9. In addition, for Securities and Exchange Commission ("SEC") regulations enacted under Sarbanes-Oxley further specifying responsibilities of (both inside and outside) supervisory and subordinate attorneys, see SEC Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. § 205.4 (2003) (Responsibilities of supervisory attorneys); 17 C.F.R. § 205.5 (2003) (Responsibilities of a subordinate attorney).

10. See 148 Cong. Rec. S6556 (daily ed. July 10, 2002) (statements of Sen. John Edwards); *id.* (statements of Sen. Jon Corzine) ("[E]xecutives and accountants work day to day with lawyers. They give them advice on almost each and every transaction. That means when executives and accountants have been engaged in wrongdoing, there have been some other folks at the scene of the crime—generally they are lawyers."); see also *infra* Part III.A.1.

11. Although the text of Sarbanes-Oxley section 307 does not employ the term "gatekeeper," it is clear from SEC staff rhetoric and legislative history that certain "gatekeeping" duties (as broadly defined *infra*) were imposed on inside counsel. See, e.g., Stephen M. Cutler, Dir., Div. of Enforcement, Speech by SEC Staff, The Themes of Sarbanes-Oxley as Reflected in the Commission's Enforcement Program (Sept. 20, 2004), available at <http://www.sec.gov/news/speech/spch092004smc.htm> (noting that, consistent with Sarbanes-Oxley's focus on the important role of lawyers as gatekeepers, the SEC has stepped up scrutiny of the role of lawyers in corporate frauds, and discussing general counsels who have been targets of SEC investigations). For purposes of this Article, I use the term "gatekeeper" broadly, not only to include private parties who can disrupt misconduct by withholding support, but also parties who may have duties to "'blow the whistle' on [primary] wrongdoers or to resign from, discharge, or otherwise punish wrongdoers." See John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 B.U. L. Rev. 301, 309 (2004) [hereinafter Coffee, *Gatekeeper Failure*] (defining "gatekeeper" as a "reputational intermediary who provides verification or certification services to investors"); John C. Coffee, Jr., *The Attorney as Gatekeeper: An Agenda for the SEC*, 103 Colum. L. Rev. 1293, 1297 (2003) [hereinafter Coffee, *Attorney as Gatekeeper*] (defining "gatekeepers" as "independent professionals who are so positioned that, if they withhold their consent, approval, or rating, the corporation may be unable to effect some transaction or to maintain some desired status"); Reinier H. Kraakman, *Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy*, 2 J.L. Econ. & Org. 53, 54 n.3 (1986) (distinguishing gatekeeping regimes from other third-party enforcement regimes, e.g., whistle-blower regimes).

12. Mahzarin R. Banaji et al., *How (Un)Ethical Are You?*, Harv. Bus. Rev., Dec. 2003, at 56 (arguing that the prevalence of counter-intentional, implicit biases suggests that people unwittingly allow unconscious thoughts and feelings to influence seemingly objective decisions).

13. See Donald C. Langevoort, *Where Were the Lawyers? A Behavioral Inquiry into Lawyers' Responsibility for Clients' Fraud*, 46 Vand. L. Rev. 75, 78 (1993) (stating that the

egregious examples of self-dealing and overt misrepresentation about the true financial condition of the company, it lacks explanatory power for most lawyer conduct in the scandals.

In my title, I suggest, like many others,¹⁴ that fraud is banal, although I make no claims to quantify the extent of fraudulent conduct.¹⁵ I do suggest, however, that the “few” in “a few bad apples” does not adequately estimate the size of the problem.¹⁶ Such a conclusion should not surprise anyone familiar with the decades of psychological research that show how cognitive biases triggered by powerful situational forces distort our ethical judgments and direct our actions.

In Part I, I discuss two models of fraud: the venality hypothesis advanced by many, and my alternative banality hypothesis. I assert that the banality hypothesis more adequately explains the problem of inside counsel’s acquiescence in fraud. I orientate the focus on inside counsel by describing an undeniable trend: the ascendance of inside counsel as the dominant provider of legal services to corporate America. I recount the role

article’s purpose is to seek other possible explanations for lawyer complicity in fraud other than “venality” or “stupidity”); Adam Cohen, *Before WorldCom, the Funeral Industry Set the Standard for Venality*, N.Y. Times, Sept. 13, 2002, at A23 (recounting President Bush’s argument that the executive misdeeds were ethical lapses of a few bad actors, and that the solution was criminal prosecution).

14. The plethora of financial restatements suggests that fraud is much more pervasive than we would like to admit. See, e.g., U.S. Gen. Accounting Office, *Financial Statement Restatements: Trends, Market Impacts, Regulatory Responses, and Remaining Challenges 4-9* (2002), available at <http://www.gao.gov/new.items/d03138.pdf> (summarizing data and noting the 145% increase in restatements due to accounting irregularities from January 1997 through June 2002); Coffee, *Attorney as Gatekeeper*, *supra* note 11, at 1300 (noting that the “sudden spike in financial restatements strongly suggests that auditors became compromised during the 1990s and acquiesced in risky and questionable accounting policies favored by corporate managements”); Press Release, Ernst & Young, *Study Finds Nearly Half of Surveyed Global Organizations Report Having Been Significantly Defrauded in the Last Year* (Feb. 3, 2003), available at http://www.ey.com/global/Content.nsf/US/Media_-_Release_-_02-03-03DC.

15. See Langevoort, *supra* note 13, at 77 (“We lack actual base-rate data establishing the incidence of complicity, or documentation of the offsetting events when attorney involvement has somehow deterred client misconduct.”).

16. See, e.g., Susan D. Carle et al., *The Evolving Legal and Ethical Role of the Corporate Attorney After the Sarbanes-Oxley Act of 2002: Ethical Dilemmas Associated with the Corporate Attorney’s New Role*, 52 Am. U. L. Rev. 655, 667 (2003) [hereinafter Panel, *Ethical Dilemmas*] (panel discussion); *id.* (comments of Susan Hackett, Senior Vice President and General Counsel of the Association of Corporate Counsel) (“[B]ecause Enron-like debacles are not widespread problems, in spite of the amount of coverage they receive and the size of these recent failures, I think that most assume that it is unlikely that they will ever have to grapple with a situation that would give rise to the reporting requirements of the Sarbanes-Oxley Act.”); Lynn E. Turner, *Just a Few Rotten Apples? Better Audit Those Books*, Wash. Post, July 14, 2002, at B1 (“In 2001, 270 public companies restated the numbers in their financial statements. . . . Those numbers prove that there are more than the ‘few bad apples’ in the orchard than President Bush would have us believe following his Wall Street speech on Tuesday.”); Editorial, *Too Little: Financial Reporting Needs Systematic Reforms*, Newsday, July 10, 2002, at A24 (“Bush . . . threw his weight behind the notion that corporate abuses . . . are the result of a few really bad apples in the business world.”).

of Tyco's general counsel in one of the largest white-collar crime cases in history to illustrate how these psychological forces may come to play in any individual case. In Part II, I seek an alternative explanation, other than venality, for why inside lawyers countenance managerial wrongdoing. Drawing heavily from the work of social and cognitive psychologists and organizational behavior literature, I suggest and explore several factors that play an important role in the ethical decision making of inside counsel. In Part III, I criticize the Securities and Exchange Commission ("SEC") regulations under section 307 of Sarbanes-Oxley and the 2003 amendments to the Model Rules of Professional Conduct for relying on an underdescriptive model of fraud, which fails to take the situation of inside counsel seriously and thus sets them up for failure under the new, congressionally mandated gatekeeper regime. In Part IV, I propose an alternative structural reform that transforms the ethical ecology of inside counsel through "independence and empowerment rules,"¹⁷ so that they can actually carry out their imposed gatekeeping responsibilities.

I. TWO MODELS OF FRAUD

A. *The Venality Hypothesis*

Tyco. On July 15, 2004, following two months of testimony and five days of jury deliberation, Mark A. Belnick, former general counsel of Tyco International Ltd., was acquitted in New York State court on charges of grand larceny, securities fraud, and falsifying business records.¹⁸ He had faced up to twenty-five years in prison for his complicity in one of the largest white-collar crime cases in history.¹⁹ Prior to joining Tyco in September 1998 Belnick had been a star litigation partner at New York's Paul, Weiss, Rifkind, Wharton & Garrison and a protégé of litigation legend Arthur Liman. He had received national attention for his role in helping Congress track down missing millions in the Iran-Contra affair.²⁰

17. Coffee, *Gatekeeper Failure*, *supra* note 11, at 335.

18. Anthony Lin, *Ex-Tyco General Counsel Belnick Found Not Guilty of All Charges*, N.Y. L.J., July 16, 2004, at 1. For the official charges, see Indictment, New York v. Belnick, No. 5258/02 (N.Y. Sup. Ct. Sept. 12, 2002); Complaint, Sec. & Exch. Comm'n v. Kozlowski, No. 1:02-CV-07312 (S.D.N.Y. Sept. 11, 2002), available at <http://www.sec.gov/litigation/complaints/complr17722.htm>.

19. Nanette Burnes, *The Hunch That Led to Tyco's Tumble*, Bus. Wk. Online, Dec. 23, 2002, <http://www.businessweek.com/print/magazine/content/02.si/b3813013.htm?chan=m2> (noting that the case against Kozlowski and Swartz is one of the largest white-collar crime cases in history).

20. Otis Bilodeau, *What Happened to Mark Belnick?*, Legal Times, Sept. 16, 2002, at 1. Mark A. Belnick tracked down a missing \$10 million payment that Lt. Col. Oliver North had solicited from the Sultan of Brunei on behalf of Nicaraguan rebels. Belnick located the money, plus \$235,000 in interest, in a numbered Swiss bank account. *Id.*

Former Senator Warren Rudman had called him “brilliant, decent and a model of integrity.”²¹

New York State prosecutors had accused Belnick of improperly receiving and concealing more than \$30 million in unauthorized compensation and loans from the company.²² The prosecution characterized Belnick’s lavish compensation and benefits, received without board approval, as “hush money” for helping former Tyco Chairman and Chief Executive Officer (“CEO”) L. Dennis Kozlowski conceal his own thefts of \$170 million from Tyco.²³ In her opening statement, Assistant District Attorney Amy Schwartz told the jury that “Belnick abused his fiduciary relationship with Tyco to line his own pockets and defraud the shareholders . . . [S]educed by the pursuit of wealth, Belnick betrayed his duty.”²⁴ Belnick’s defense asserted that Belnick’s compensation was fully earned and in line with customary Tyco compensation practices. Moreover, they argued, Belnick reasonably relied on his boss, Kozlowski, and former Chief Financial Officer (“CFO”) Mark H. Swartz on issues of board approval and disclosure.²⁵

The Belnick criminal case captures one of the most important debates still going on in reaction to the recent corporate scandals and the SEC’s attempts to reform attorneys’ professional responsibilities under Sarbanes-Oxley. It poses the question of what, if any, ethical duties lawyers should

21. *Id.* In 1998, Warren Rudman, a partner at Paul, Weiss, recommended Belnick for the job of chief counsel of Tyco. *Id.* at 18.

22. Anthony Lin, *Trial Starts for Tyco’s Belnick*, Nat’l L.J., May 10, 2004, at 18. In her opening statement, prosecutor Amy Schwartz argued that Belnick received an improper multimillion dollar bonus, failed to disclose his compensation to the board, and repeatedly failed to report more than \$14 million in company relocation loans. Jonathan D. Glater, *Latest Tyco Trial Starts as Lawyers’ Showcase*, N.Y. Times, May 7, 2004, at C2. As the trial unfolded, the prosecution focused on Belnick’s \$17 million bonus as a bribe from L. Dennis Kozlowski. See Steve Fishman, *The Convert*, NewYorkMetro.com, Aug. 9, 2004, www.newyorkmetro.com/nymetro/news/people/features/9572/index.html.

23. Brooke A. Masters & Carrie Johnson, *Former Tyco Executive Acquitted*, Wash. Post, July 16, 2004, at E1. Chief Executive Officer (“CEO”) Kozlowski and Chief Financial Officer (“CFO”) Mark Swartz were found guilty on June 17, 2005, of conspiracy, fraud, and falsifying business records. Martha Graybow, *Former Tyco Chiefs Found Guilty*, Reuters, June 17, 2005, available at http://www.news-from-newspapers.com/en/reuters.com/2005/06/18/Former_Tyco_chiefs_found_guilty.html. Kozlowski and Swartz were charged with abusing two company loan programs for executives—instead of using the loans for approved purposes, they allegedly used those funds toward their extravagant lifestyles, palatial estates, and generous perquisites from Tyco. For an in-depth description of Kozlowski’s excesses, see James B. Stewart, *Spend! Spend! Where did Tyco’s Money Go?*, The New Yorker, Feb. 17, 2003, at 132.

24. Glater, *supra* note 22 (quoting Assistant District Attorney Amy Schwartz).

25. Anthony Lin, *Belnick Testifies He Soon Felt Out of Place at Tyco*, N.Y. L.J., June 23, 2004, at 1 [hereinafter Lin, *Belnick Testifies*] (reporting that Kozlowski told Belnick that compensation at Tyco was “very generous”); Anthony Lin, *Skewed Views of Business Sparked Belnick Case, His Attorney Claims*, N.Y. L.J., July 7, 2004, at 1 [hereinafter Lin, *Skewed Views*] (reporting the defense argument that Belnick “reasonably relied” on Kozlowski and Swartz on issues of board approval and disclosure); Anthony Lin, *Trial Under Way for Tyco Ex-GC Mark Belnick*, N.Y. L.J., May 7, 2004, at 1 [hereinafter Lin, *Trial Under Way*] (noting defense argument that Belnick earned his lavish compensation).

have in preventing or reporting corporate fraud? It focuses on the related, but more narrow question: What is and what should be the role of the general counsel, a company's top legal dog? In closing arguments, the defense counsel, Reid Weingarten of Steptoe & Johnson, said that the prosecution had based its case on "wildly unrealistic" ideas of how a general counsel or any other employee would interact with his superiors in a corporate setting. According to Weingarten, the Manhattan District Attorney's mistake was to presume that Belnick "'wasn't the general counsel [but] the inspector general.'"²⁶ As his defense attorney argued, Belnick "'never saw his role as watchdog of the board.'"²⁷

Belnick's acquittal leaves many questions open, especially for those familiar with the role of general counsel. We wonder how he could have been so gullible or mindless to have missed the red flags. To what extent had Belnick enabled the wholesale pillaging of Tyco by the CEO and CFO? Why did he not take it upon himself to investigate the possibility that Kozlowski might be abusing the company loan programs (as suggested by his outside counsel)?²⁸ Why did he not more aggressively investigate the \$100,000 in vacation expenses for Kozlowski's girlfriend Karen Mayo that were paid out of a reserve designated for Tyco merger expenses?²⁹ Or the \$250 million that Kozlowski borrowed from Tyco to pay for everything from dentist bills to beach house expenses for Mayo?³⁰ Why did Belnick not do anything to address the unorthodox practice of using various cash reserves to beef up cash flow in order to meet forecasts (a practice that outside securities counsel had alerted him to)?³¹ Why did he not take it upon himself to ensure that his large cash and restricted stock bonuses (valued at approximately \$20 million in the calendar year 2000 alone) were approved by the Board, instead of just relying on Kozlowski's word (which he had good reason to distrust)?³² Why did he fail to report his interest-free loans of \$14 million in the directors-and-officers questionnaires used to

26. Lin, *Skewed Views*, *supra* note 25, at 1.

27. *Id.* at 2.

28. Anthony Lin, *Wilmer Lawyers Shake Up Trial of Tyco GC*, *Legal Times*, June 7, 2004, at 1 (noting that Wilmer lawyers were satisfied with the explanation that senior executives were using the company loan program as a "revolving credit arrangement").

29. Anthony Lin, *At Belnick Trial, One Firm is Key to Both Sides*, *Nat'l L.J.*, June 7, 2004, at 17.

30. Fishman, *supra* note 22. Belnick inquired about these expenses and was told that Kozlowski brought the balance to zero by the end of the year. It was later discovered that Kozlowski had reduced the balance by using other company loan programs and by forgiving some of those loans.

31. Lin, *supra* note 28.

32. Press Release, Tyco International, Ltd., Tyco Files Suit Against Former Chief Corporate Counsel Mark Belnick for Broad Pattern of Misconduct Including Using Company Funds for Personal Gain (June 17, 2002), *available at* <http://www.tyco.com/livesite/Page/Tyco/Who+We+Are/Press+Center/Press+Releases+Details/??&DCRID=1290380366>.

prepare the company's SEC filings?³³ Why did he defer to CFO Swartz about what should or should not be disclosed in an SEC filing?³⁴ The Manhattan District Attorney queried Belnick incredulously at trial, "'Weren't you . . . the company lawyer?'"³⁵

The conventional wisdom. Because Belnick's apparent lapses in judgment seem implausible in light of his celebrated reputation, the conventional explanation is what I call the venality hypothesis.³⁶ Notwithstanding the acquittal, the assumption is that, at some point in his career, Belnick met a fork in the road and consciously and deliberately chose the path of greed and depravity. In explaining his silence in the face of Kozlowski's looting of the company, it is easy to assume that Belnick willfully turned the other way. This explanation has many virtues. It reflects a medieval morality play with a simple lesson. It also provides great comfort by ratifying the sacred notion of free will³⁷ and, conservatively, isolating the problem of corruption to a handful of aberrant cases. Paradoxically, some form of the venality hypothesis has been used by law reformers to justify the stiff penalties of Sarbanes-Oxley³⁸ and by

33. Otis Bilodeau, *Indicted GC Telegraphs His Defense, Mark Belnick: Tyco Executives Knew About Disputed Loans*, Legal Times, Oct. 28, 2002, at 1 (reporting that Belnick received assurance from Swartz that relocation loans did not have to be disclosed).

34. *Id.*

35. See Fishman, *supra* note 22 (quoting Assistant District Attorney John Moscow).

36. One partner at Paul, Weiss wondered, "'If shenanigans were going on under Mark's nose, where was the ethical guidance? . . . Mark should have known better, his antennae should've been raised, he had to look the other way.'" *Id.*; see, e.g., TYCO Former Executives L. Dennis Kozlowski, Mark H. Swartz and Mark A. Belnick Sued for Fraud, Accounting and Enforcement Act Litigation Release No. 17,722, 78 SEC Docket 1495 (Sept. 12, 2002), available at <http://www.sec.gov/litigation/litreleases/lr17722.htm>; see also John Freeman, *Ethics Watch: Lawyers and Corporate Disgrace*, 14 S.C. Law. 9 (2003). John Freeman writes,

[Kozlowski and Belnick] 'treated Tyco as their private bank, taking out hundreds of millions of dollars of loans and compensation without ever telling investors, [and, in doing so] put their own interests above those of Tyco's shareholders.'

. . . Evidently, lawyer Belnick was willing to grease the skids for Mr. Kozlowski's sophisticated looting of Tyco in exchange for Mr. Kozlowski greasing his lawyer's palms . . . [I]t is impossible to justify corporate counsel standing by, much less splitting the booty, when the entity, the "client," is being looted.

Id. at 9 (quoting SEC Director of Enforcement Stephen M. Cutler). The venality hypothesis has been generalized to other corporate scandals. See, e.g., Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals about Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 Geo. L.J. 285, 286 (2004) (noting that "unrestrained greed has now become the standard trope in the social construction" of recent corporate scandals).

37. See Daniel M. Wegner, *The Illusion of Conscious Will* 28 (2002) (quoting Marvin Minsky, *The Society of Mind* 306 (1985) ("None of us enjoys the thought that what we do depends on processes we do not know; we prefer to attribute our choices to *volition*, *will*, or *self-control* . . . Perhaps it would be more honest to say, '*My decision was determined by internal forces I do not understand.*'")).

38. See Geraldine Szott Moohr, *An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime*, in *Enron: Corporate Fiascos and Their Implications*, *supra* note 7, at 431, 445 (noting that "[t]he overwhelming characteristic of Sarbanes-Oxley's new

those resisting further regulation, because, in their view, “corporate law reform . . . should not be assessed from such a small sampling of” failures caused by unrestrained greed.³⁹

But the simplest explanation is not always the correct one. In fact, decades of social scientific research into the causes and nature of unethical behavior suggest that the venality hypothesis is too simplistic. It fails to capture the complex interaction between the powerful situational forces, and the psychological tendencies unleashed by those forces, that can impede professional judgment. Belnick may not simply be one of the few rogue apples. Rather, he is a symbolic marker, an illustrative, albeit extreme, example of the kinds of pressures that all inside counsel face when the senior officer to whom they report is engaged in misconduct, whether overtly criminal or just subtly dishonest. In some ways obviously exceptional, the circumstances of Belnick’s corruption may also be banal.

B. *The Banality Hypothesis*

Now imagine that you are a college student in need of a little money. You answer a newspaper advertisement promising to pay volunteers \$40 in cash for participating in a one-hour experiment on “memory and learning,” conducted by a professor of the Psychology Department.⁴⁰ In the research facility, you greet the “experimenter,” wearing a gray lab coat and carrying a clipboard, who takes you into a laboratory where a friendly, bespectacled middle-aged man—another volunteer—waits. The experimenter then describes the purpose of the study as exploring the possible benefits of selective punishment on memory errors. He instructs you and the other volunteer to draw a slip of paper from a hat, which randomly determines which one is to play the role of “teacher” and which one “learner” in the experiment. You go first, and you draw the slip of paper with the word “Teacher.”

criminal provisions is the severity of its prison terms,” and summarizing the enhanced penalty provisions).

39. See Langevoort, *supra* note 36, at 286-87 (noting that, for those opposed to law reform, “the assumption of greed with guile in response to institutional incentives explains enough”).

40. This hypothetical is based on actual experiments conducted by Stanley Milgram of Yale University. See Stanley Milgram, *Obedience to Authority* 14-26 (1974); see also Jon Hanson & David Yosifon, *The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture*, 152 U. Pa. L. Rev. 129, 150-54 (2003) (using Milgram’s experiments as the basis for an illustrative hypothetical on situationism versus dispositionism); David J. Luban, *The Ethics of Wrongful Obedience, in Ethics in Practice: Lawyers’ Roles, Responsibilities, and Regulation* 94, 96-97 (Deborah L. Rhode ed., 2000) (using Milgram’s experiments to explain the behavior of Mahlon Perkins in the *Berkey-Kodak* case, and as the basis for an exposition on the excuse doctrine in criminal law); Philip G. Zimbardo & Michael R. Leippe, *The Psychology of Attitude Change and Social Influence* 65-72 (1991) (providing a summary and analysis of Milgram’s experiments). The compensation was \$4 (plus fifty cents carfare) for the actual experiments conducted by Milgram in the early 1960s.

The experimenter then tells you that you are to read a series of random word pairs to the learner and then test the learner's memory of the pairing of the words. Incorrect answers are to be punished with an electric shock, delivered by flipping one of the thirty switches of a "shock generator" that the experimenter shows you.⁴¹ You briefly inspect the shock generator. Each switch is clearly labeled (from left to right in fifteen-volt increments) with voltage designations that range from fifteen to 450 volts.⁴² In addition, markings ranging from "Slight Shock" to "Danger: Severe Shock" accompany each group of four switches. Two switches after this last designation (435 to 450 range) are ominously marked "XXX."⁴³ The experimenter instructs you, as the teacher, to punish the first error with a mild fifteen-volt shock and then to increase the shock by fifteen volts for each succeeding error.⁴⁴

Then, as you tag along, the experimenter takes the learner to an adjacent room and straps him into an "electric chair" apparatus.⁴⁵ The experimenter explains that the straps "prevent excessive movement while the learner [is] being shocked An electrode is attached to the learner's wrist, and electrode paste is applied to avoid blisters and burns."⁴⁶ The experimenter then explains that the electrode is attached to the shock generator in the adjoining room.⁴⁷ The learner looks a little nervous and mentions that he has a "slight heart condition," but the experimenter reassures him that, "[a]lthough the shocks can be extremely painful, they cause no permanent tissue damage."⁴⁸

The experimenter then escorts you to your seat in the main room in front of the shock generator. He gives you a sample shock of forty-five volts, which makes you flinch a little.⁴⁹ The experimenter then instructs you to administer the learning task. You administer the learning task and the learner responds correctly. Subsequently, however, the learner errs, and you flip the switches at fifteen volts. Wrong answers continue and you administer thirty and then forty-five volts. At seventy-five volts, the learner grunts; at 120 volts, he complains verbally; at 150 volts, he demands to be released from the experiment.⁵⁰

At this point, you feel a little discomfort at the learner's demands. You turn to the experimenter and say, "Maybe we should stop this. It sounds like it's getting to be painful for him. He said he had a slight heart

41. See Zimbardo & Leippe, *supra* note 40, at 66.

42. Milgram, *supra* note 40, at 20.

43. *Id.*

44. Zimbardo & Leippe, *supra* note 40, at 67.

45. Milgram, *supra* note 40, at 19.

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.* at 20.

50. "His protests continue as the shocks escalate, growing increasingly vehement and emotional. At 285 volts his response can only be described as an agonized scream." *Id.* at 4.

condition.”⁵¹ The experimenter immediately counters, “The experiment requires that you continue to go on. Please go on!”⁵²

What would you do in this situation? At what point would you disobey the experimenter’s commands? How far do you think other ordinary people—like you—would administer brutal and perhaps lethal shocks at the command of the experimenter?

The scenario that I just described to you is, of course, based on the famous experiments⁵³ conducted by Stanley Milgram⁵⁴ from 1960-1963 to study the psychological mechanisms of obedience to authority. Milgram recruited over one thousand subjects from a diverse cross section of the entire New Haven community to participate in his experiments.⁵⁵ The original and basic design of the experiments included three actors: the experimenter (who was played by a high school teacher of biology), the learner (an accountant trained for the role), and the teacher (who was the naïve volunteer subject).⁵⁶ But, through eighteen different permutations of the experiments, Milgram manipulated various situational factors to test their effect on actual behavior.⁵⁷ The “random” drawing from the hat was rigged so that the naïve subject always drew the slip of paper designated “Teacher.”⁵⁸ Actual shocks were not delivered and the shouts and screams were preprogrammed on tape.⁵⁹

What was the expected behavior of subjects? Three groups of people—psychiatrists, college students, and an audience of middle-class adults of varied occupations—were given a detailed presentation describing the experiment and were asked to predict when hypothetical subjects would disobey the experimenter. They predicted that the majority of subjects would not go beyond the tenth shock level (150 volts, when the learner makes his first explicit demand to be freed) and that only a pathological fringe, not exceeding one or two percent, would proceed all the way to 450

51. *See id.* at 65.

52. *See id.* at 21.

53. Although it has been four decades since those experiments were conducted, Milgram’s research is “perhaps the most widely cited program of studies in psychology,” achieving “a visibility that is without precedent in the social sciences.” A.G. Miller, *The Obedience Experiments: A Case Study of Controversy in the Social Sciences*, at v (1986). Miller notes that “the number of references to the obedience research—in the *Science Citation Index*, for example—is truly vast.” *Id.* at vi.

54. Milgram remains highly respected in the field. In a tabulation of citations in introductory psychology texts, it was noted that Milgram ranked twelfth among all psychologists, “just behind Carl Jung and higher than William James, John B. Watson, Abraham Maslow, or Leon Festinger.” *See id.* at 2.

55. Alan C. Elms, *Obedience in Retrospect*, Alan C. Elms Virtual Library, <http://www.ulmus.net/ace/library/obedience.cfm>; *see also* Milgram, *supra* note 40, at 14-16.

56. Milgram, *supra* note 40, at 16-17.

57. *See* Zimbardo & Leippe, *supra* note 40, at 71 fig.25 (summarizing the results of the eighteen experiments).

58. *See* Milgram, *supra* note 40, at 19.

59. *See* Zimbardo & Leippe, *supra* note 40, at 68.

volts (thirtieth shock level).⁶⁰ Moreover, no one believed that they themselves would go all the way.

The results from the baseline experiment were startling, even to Milgram himself. Of the first forty subjects, twenty-six (sixty-five percent) obeyed the orders of the experimenter to the end, punishing the learner until they reached the maximum shock on the generator. They did so in spite of the victim's agonized screams, poundings on the wall, and, even later, chilling silence. Moreover, comparable results have been attained by other researchers in experiments conducted using subjects with different demographic characteristics, in foreign countries, and in non-laboratory conditions.⁶¹ After the 450-volt shock was administered three times, the experimenter terminated the session.⁶² The average maximum shock level administered by the subjects was 27.0, or 405 volts, quite a bit more than the 150 volts (tenth shock level) predicted as the level that most hypothetical subjects would refuse to administer.⁶³ As succinctly put by David Luban, "Milgram demonstrates that each of us ought to believe three things about ourselves: that we disapprove of destructive obedience, that we think we would never engage in it, *and, more likely than not, that we are wrong to think we would never engage in it.*"⁶⁴

The large discrepancy between ex ante predictions about likely behavior and actual behavior of subjects confirms the existence of what is called the fundamental attribution error⁶⁵—that we grossly under-attribute the relevance of situational influences on our behavior and over-attribute the strength of dispositional factors. Dispositional (or internal) attributions identify the causes of observed behavior as within the individual, i.e., personality or motives.⁶⁶ By contrast, situational (or external) "attributions identify factors in the social and physical environment that are causing the person to behave in a particular way."⁶⁷ Situational forces may include the physical setting, roles, rules, uniforms, symbols, or, as will be discussed in

60. The surveyed respondents predicted that about four percent would reach the twentieth shock level and about one subject in a thousand would administer the highest shock. See Milgram, *supra* note 40, at 30 fig.5, 31.

61. See Miller, *supra* note 53, at 67-87 (summarizing other researchers' findings).

62. Milgram, *supra* note 40, at 33. It is this sixty-five percent obedience result that has received the most publicity, although Milgram would later express reservations concerning the manner in which his findings were assimilated by the public, focusing on the baseline experiment and largely ignoring the programmatic nature of Milgram's experiments. See Miller, *supra* note 53, at 9.

63. See Miller, *supra* note 53, at 21.

64. Luban, *supra* note 40, at 97.

65. Hanson & Yosifon, *supra* note 40, at 136 (arguing that legal economists' inability to analyze themselves through the same economic models they apply to everyone else is explained by the fundamental attribution error); see also Ziva Kunda, *Social Cognition: Making Sense of People* 430 (1999) (noting that participants in psychological studies routinely "fail to appreciate the extent to which situational forces had contributed to that behavior" and instead "tend to attribute behaviors to the enduring traits or abilities of the person who had performed them").

66. Zimbardo & Leippe, *supra* note 40, at 89.

67. *Id.* at 90.

this Article, group consensus.⁶⁸ Milgram's experimental variations showed that "obedience is powerfully influenced by relevant situational contexts—that it is capable of being produced at an extremely high rate or reduced to a complete absence *without taking into account any personality factors in the individual research participants*."⁶⁹

Put another way, we are prone to overestimate the degree of stability likely to be demonstrated in a given individual's behavior over time and across different situational contexts.⁷⁰ We thus tend to rely heavily on overly broad and simplistic notions of "good" or "bad" character, both in our efforts to explain past behavior and predict future behavior.⁷¹ Even when we do recognize the situational constraints inducing a person's behavior, we do not always take them into account.⁷² Frequently, we jump to conclusions about the person's underlying trait and fail to sufficiently correct our inferences by adjusting for the situational context.⁷³

If the shocking context of Milgram's experiment makes one skeptical about generalizing his findings, rest assured that the evidence demonstrating the fundamental attribution error is now legion. The fundamental attribution error is considered "pervasive and so full of implications" and "one of the major lessons of social psychology."⁷⁴ Evidence for the fundamental attribution error "abound,"⁷⁵ and classic studies proving the fundamental attribution error⁷⁶ are now fixtures of psychology textbooks.

The venality hypothesis suffers badly from the fundamental attribution error. The venality explanation assumes a calculating and "self-contained decision-maker[] flying solo," ignoring the scientific wisdom that the "dynamics of individual decision making change dramatically when the individual works in an organizational setting."⁷⁷ Like the laboratory at Yale, the corporate setting is just another situational cue that gives legitimacy to the authority's orders and thus demands that those orders be followed. To understand why an inside lawyer makes unethical choices, do not just inquire about her values or peer into her heart; ask her where she sits on the organizational chart as well.

68. *Id.* at 93.

69. Miller, *supra* note 53, at 255 (summarizing Milgram's position).

70. Lee Ross & Donna Shestowsky, *Contemporary Psychology's Challenges to Legal Theory and Practice*, 97 Nw. U. L. Rev. 1081, 1092 (2003).

71. *See id.* at 1093.

72. Kunda, *supra* note 65, at 431.

73. *Id.*

74. Zimbardo & Leippe, *supra* note 40, at 93.

75. *Id.* at 94.

76. *See, e.g.,* Kunda, *supra* note 65, at 429-30 (summarizing the classic Quiz Game experiment, and pro-Castro essay experiment).

77. Luban, *supra* note 40, at 94.

This is my alternative banality hypothesis.⁷⁸ It suggests that the behavioral origins of lawyer acquiescence in corporate fraud are found in commonplace interactions in organizational settings. In other words, what we perceive as “extraordinary behavior” on the part of inside counsel is better explained by analyzing what is “ordinary behavior” in the corporate workplace.⁷⁹ Resisting the fundamental attribution error, my hypothetical suggests that unethical decisions made by inside counsel are better explained by the particular situation in which the inside counsel finds herself and the particular roles—mere employee, faithful agent, and team player—that constrain her actions. This situation is configured by economic, psychological, and ideological forces that incline the inside counsel to be complicit in fraud, not through any overt or explicit calculation, but through a subtle and implicit reconfiguration of preferences, self-conception, and motivation.

To be clear, I am not saying that a venality explanation is never correct. It may be, even in a nontrivial number of cases. Rather, my point is that the banality hypothesis has better explanatory power for the typical inside counsel situation, and that attempts to reform the “system” ignore this model of fraud at their own peril.

C. Focusing on Inside Counsel

Before making my case for the banality hypothesis, I will justify my focus on inside counsel as gatekeeper. Put simply, the inside counsel is the single most important lawyer in a securities fraud committed by a public company and, as Ronald Gilson has argued, the logical lawyer candidate for the gatekeeping function.⁸⁰ This explains why Belnick, the general counsel, was given such ridiculous sums of money by Kozlowski in the Tyco scandal. Kozlowski needed to do everything he could to put Belnick in his back pocket. In other words, Belnick’s inaction at Tyco was a necessary condition for corporate fraud to continue. This explains why Congress conscripted the public company’s general counsel, or CLO, to be a gatekeeper, and why the SEC has recently stepped up its enforcement efforts against inside counsel as gatekeepers.⁸¹

78. The “banality hypothesis” derives from the oft-cited “normality thesis” of Milgram’s experiments. The “normality thesis” is situational in its focus, but recognizes that situations are the product of people. It refutes the “pathology thesis” as the primary explanation for evil; that is, it denies the proposition that evildoers are necessarily “different” from normal people in terms of basic psychological functioning. See Miller, *supra* note 53, at 184-85.

79. See Zimbardo & Leippe, *supra* note 40, at 70-71 (discussing the normality thesis of Milgram’s experiments).

80. See Ronald G. Gilson, *The Devolution of the Legal Profession: A Demand Side Perspective*, 49 Md. L. Rev. 869, 915 (1990) (arguing that, since the market power necessary for private gatekeeping has moved in-house, so, too, must the gatekeeping function).

81. See Cutler, *supra* note 11, at 1 (listing general counsels who allegedly were complicit in fraudulent conduct and noting that about half of all lawyers charged with misconduct were inside counsel). In addition, the SEC has been investigating inside and

Within the corporate structure. Inside counsel have gained influence, both within the corporate structure and also as compared to the role of outside counsel. Most general counsels now sit at the top of the corporate hierarchy.⁸² The general counsel formally participates in planning committees and, in many cases, is a member of the senior management council or committee where final decisions are made.⁸³ She typically reports to the CEO⁸⁴ and has the trust of senior management, who may be suspicious of retained lawyers.⁸⁵ She is involved early in the decision-making process and, thus, is capable of influencing management decisions at the strategy-setting stage. She has significant managerial responsibilities, including the education and monitoring of lay employees with respect to corporate compliance.⁸⁶

Due to her physical proximity to management and other company employees, the inside lawyer has substantial access to informal sources of information collected around the "water cooler."⁸⁷ This great access means that the inside lawyer better understands the internal workings and philosophy of the corporation than even the best outside counsel.⁸⁸ The downside, of course, is greater opportunity to learn of corporate

outside lawyers of mutual funds whom it believes assisted their clients "in illegal late trading or market timing arrangements that harmed mutual fund investors." *Id.*

82. Abram Chayes & Antonia H. Chayes, *Corporate Counsel and the Elite Law Firm*, 37 Stan. L. Rev. 277, 277 (1985).

83. *Id.* at 282 (describing the trend toward formal integration of inside counsel into the corporate planning process).

84. A survey conducted by American Corporate Counsel Association ("ACCA" or "ACC") in 2001 reported that 61.4% of general counsels reported to the CEO, 15.3% reported to the president, and 12.7% reported to another executive. Approximately 7% of respondents indicated that the general counsel reported to the CFO. Susan Hackett, *Inside Out: An Examination of Demographic Trends in the In-House Profession*, 44 Ariz. L. Rev. 609, 612 (2002) (reporting survey results and noting that general counsels are fighting the trend to transfer reporting to the CFO).

85. According to a 1995 study conducted by Checkers, Simon & Rosner, L.L.P., approximately 40% of the CEOs and 45% CFOs surveyed believed they were being overcharged by their outside counsel. Checkers, Simon & Rosner, L.L.P., *What Corporate Clients Think of Outside Counsel Billings*, Nat'l L.J., Sept. 25, 1995, at A5.

86. See Chayes & Chayes, *supra* note 82, at 284-87 (describing the role of inside counsel in developing programmatic prevention plans); Richard S. Gruner, *General Counsel in an Era of Compliance Programs and Corporate Self-Policing*, 46 Emory L.J. 1113, 1141-63 (1997) (discussing the role of general counsel in corporate compliance).

87. As described by Geoffrey Hazard, the "water cooler" refers to the places and occasions for informal information interchange that occur in all employment settings: the company cafeteria, the car pool, the informal exchanges preceding company committee meetings, the evening get-togethers during out-of-town trips, and even the company picnics. These are opportunities for exchange of back-channel information, office gossip, rumors and portents of future corporate undertakings that have not yet been announced officially.

Geoffrey C. Hazard, *Ethical Dilemmas of Corporate Counsel*, 46 Emory L.J. 1011, 1018 (1997).

88. See Mary C. Daly, *The Cultural, Ethical, and Legal Challenges in Lawyering for a Global Organization: The Role of the General Counsel*, 46 Emory L.J. 1057, 1060-61 (1997) (noting that many believe they receive superior work from lawyers who are more knowledgeable about the business affairs of the company).

misconduct, even when the inside lawyer is not actively policing the organization. This puts all but the most cloistered inside counsel in the stressful position of being reminded of their fiduciary duty of loyalty and potentially having to do so something about it. Sticky situations like this lead academics, like Geoffrey Hazard, to observe that “the role of corporate counsel is among the most complex and difficult of those functions performed by lawyers.”⁸⁹

As compared to outside counsel. Since the late 1970s, inside counsel have consolidated their position as the dominant providers of legal services to corporate America.⁹⁰ Although not without a few minor countertrends,⁹¹ corporations have increasingly internalized their legal “diagnostic and referral needs” by building sophisticated in-house legal staffs⁹² to whom the handling of legal matters are entrusted.

The flip side of the increasing domination by inside counsel is the decreasing importance of the role of outside counsel. Law firms have been displaced by inside counsel as the primary advisor to corporations and have lost the function of general counsel.⁹³ Corporations now routinely shop for outside lawyers, often holding “beauty contests” where law firms are forced to compete for the right to do legal work.⁹⁴ In most large corporations, the decision whether to retain outside counsel or handle the issue internally is

89. See Hazard, *supra* note 87, at 1011.

90. See *id.* at 1012 (noting that the “second-class citizenship” previously assigned to in-house attorneys has now ceased as a result of changes in corporations’ reliance on in-house legal departments and changes in legal practice generally); Carl D. Liggio, *The Changing Role of Corporate Counsel*, 46 Emory L.J. 1201, 1201 (1997) (arguing that corporate counsel have become the dominant providers of legal services to corporate America, while outside counsel have become “episodic” providers of legal services).

91. In his research on the redesigned corporations of the high technology industry in the 1990s, Robert Rosen has observed a few countertrends (e.g., outsourcing, porous borders, and in-house downsizing) that may have negatively impacted but not reversed the larger trend of the ascendance of inside counsel (relative to outside counsel). Robert Eli Rosen, “We’re All Consultants Now”: *How Change in Client Organizational Strategies Influences Change in the Organization of Corporate Legal Services*, 44 Ariz. L. Rev. 637, 642, 647, 650 (2002).

92. See Gilson, *supra* note 80, at 889, 902-03 (observing that corporations have internalized the “diagnostic” function (identifying what legal service is needed) and “referral” function (selecting the appropriate provider of the category of legal service) by hiring in-house legal staffs and thus reducing the traditional information asymmetry between lawyer and client).

93. See Chayes & Chayes, *supra* note 82, at 298; Gilson, *supra* note 80, at 897-99, 902-03 (noting that corporations’ increasing reliance on sophisticated in-house legal staffs has resulted in a dramatic reduction in the lawyer-switching costs that historically gave law firms *de facto* power over even the largest corporate clients); Hackett, *supra* note 84, at 611 (noting that the growing visibility of the in-house bar is due largely to a shift in the balance of power between outside and in-house counsel, and not to any significant growth in the number of inside counsel relative to other segments of the bar).

94. David B. Wilkins, *Do Clients Have Ethical Obligations to Lawyers? Some Lessons from the Diversity Wars*, 11 Geo. J. Legal Ethics 855, 884 (1998).

made by the general counsel, not by ordinary executive management.⁹⁵ Previously, only routine matters would be dealt with in-house. Now, inside counsel tend to keep for themselves matters of increasing complexity and importance.⁹⁶ Outside counsel's role and scope of work are routinely constrained by inside counsel, who see law firms' judgments as being clouded by their pecuniary interest (through billable hours) in transactions or litigation proceedings.⁹⁷

Even when outside counsel is retained on a critical legal matter, it is the inside counsel that primarily participates in creating and developing legal strategies, and in acting as the main intermediary to the corporation.⁹⁸ Law firms are increasingly subject to exacting supervision over virtually every aspect of the services they perform, and law firm partners know that business will be taken away if inside lawyers become dissatisfied with the quality or price of their work.⁹⁹ Without access to "back channel" information,¹⁰⁰ elite law firms are increasingly processing legal work that has been predigested and organized by their clients' inside lawyers. Law firms may be directed to provide opinions based on "purely hypothetical"¹⁰¹ facts, selected precisely to accommodate a response that leads to a desired legal opinion.¹⁰²

For instance, in response to the famous Watkins memo, warning that Enron might implode in a "wave of accounting scandals," General Counsel James Derrick limited the "preliminary" investigation by instructing outside law firm Vinson & Elkins¹⁰³ not to second-guess Arthur Andersen's treatment of underlying accounting issues, not to do a detailed analysis of the transactions in question, and not to conduct a discovery-style

95. Chayes & Chayes, *supra* note 82, at 277-78; Robert Eli Rosen, *The Inside Counsel Movement, Professional Judgment and Organizational Representation*, 64 Ind. L.J. 479, 484 (1989).

96. Chayes & Chayes, *supra* note 82, at 277-78; *see also* Robert L. Nelson & Laura Beth Nielsen, *Cops, Counsel, and Entrepreneurs: Constructing the Role of Inside Counsel in Large Corporations*, 34 Law & Soc'y Rev. 457, 458 (2000).

97. *See* Rosen, *supra* note 91, at 652 (noting that the best practice for mergers and acquisitions ("M&A") in the redesigned corporation is to avoid contacting outside counsel early in the deal, as law firms are financially biased in having the M&A deal proceed); *see also* Mark C. Suchman, *Working Without a Net: The Sociology of Legal Ethics in Corporate Litigation*, 67 Fordham L. Rev. 837, 849 (1998).

98. *See* Nelson & Nielsen, *supra* note 96, at 458; Rosen, *supra* note 95, at 484.

99. *See* Wilkins, *supra* note 94, at 884.

100. *See* Hazard, *supra* note 87, at 1019 (noting that back-channel information cannot be recreated even when the outside lawyer has received all relevant documents and has open access to company employees).

101. *See* Rosen, *supra* note 95, at 485; *see also* ABA Standing Comm. on Ethics and Prof'l Responsibility, Formal Op. 346 (1982).

102. *See* Hazard, *supra* note 87, at 1019.

103. Watkins was opposed to hiring Vinson & Elkins, knowing that they had a conflict of interest because they provided some true sale opinions on some of the questionable deals. Memorandum from Sherron Watkins, Vice President for Corporate Dev., to Kenneth Lay, Chairman & CEO (Aug. 22, 2001), *available at* <http://energycommerce.house.gov/107/hearings/02142002Hearing489/tab11.pdf>.

investigation.¹⁰⁴ It is thus hardly surprising that Vinson & Elkins delivered a report to Enron's management that no further scrutiny into Sherron Watkins's allegations was necessary.¹⁰⁵

Given inside counsel's influential role within the corporation and outside counsel's reduced ability to act as gatekeepers to constrain client demands,¹⁰⁶ it makes perfect sense to focus on inside counsel's role as gatekeeper, a role that Congress and the SEC have imposed on inside counsel. Having motivated the focus on inside counsel, we now turn to a thicker description of the situation.

II. THE ETHICAL ECOLOGY OF INSIDE LAWYERS

The banality hypothesis takes the situation seriously. Three facets of the situation of inside counsel capture the forces that guide (un)ethical behavior. First, the inside counsel is simply an employee of the firm—and employees tend to listen to their bosses. Second, these employees are also professionalized to view themselves as agents, which requires alignment to their principal. Finally, as part of the firm, inside counsel are expected to be team players, which invites acquiescence and silence in the face of corporate misconduct.

A. *The Situation*

1. Mere Employee

a. *Obedience Pressures*

The point here is simple: We are generally inclined to take orders from superiors. Inside counsel, as employees of the firm, are thus inclined to take orders from their employer-bosses. Technically, the employer is the firm itself, but in practice, that means the management is the employer as representative of the firm. Although the general counsel of most corporations is considered a member of senior management, she invariably reports to another member of senior management, usually the CEO, a co-agent but de facto boss.

To varying degrees, we have all internalized a tendency to obey authority figures. Recall again Milgram's work. Let us assume that you were one of

104. Letter from Max Hendrick, III, Vinson & Elkins, to James V. Derrick, Jr., Executive Vice President & General Counsel, Enron Corp., Preliminary Investigation of Allegations of an Anonymous Employee (Oct. 15, 2001), available at 2001 WL 1764266 [hereinafter V&E Report].

105. *Id.* at *7 (“[T]he facts disclosed through our preliminary investigation do not, in our judgment, warrant a further widespread investigation by independent counsel and auditors.”). The report acknowledged, however, that “there is a serious risk of adverse publicity and litigation.” *Id.*

106. See Gilson, *supra* note 80, at 902-03.

the defiant subjects who refused to go all the way and stopped at, say, 300 volts. What would you do after you quit? Would you check into the adjacent room and see if the learner is seriously injured?¹⁰⁷ Shockingly, not one of the more than one thousand subjects in Milgram's experiments checked on the person they had possibly harmed.¹⁰⁸ As explained by Philip Zimbardo and Michael Leippe,

“Stay in your seat, until I tell you that you can leave,” is perhaps one of the most lasting lessons of our early childhood education—coming from elementary school teachers. That behavioral rule is so internalized that it controlled the reactions of the “heroes” in the Milgram studies, who disobeyed the experimenter's external command but totally obeyed this more deeply ingrained internal command.¹⁰⁹

Milgram argued that, in modern society, the child is socialized to obey not just mom and dad, but impersonal, legitimate authority figures—for example, schoolteachers, police officers, and bosses.¹¹⁰ To Milgram, a “legitimate” authority figure is one who is seen as having a right to issue commands and to whom one feels an obligation to obey.¹¹¹ Mere indications of rank—dress, diploma, title, insignia—are often sufficient to indicate “legitimate” authority.¹¹² In organizational settings, people interact with others on the basis of their role or position¹¹³ and are socialized to behave according to the wishes of “legitimate” authorities.¹¹⁴

But how can “legitimate” authority elicit destructive obedience in ordinary people? Milgram theorized that people tend to accept the definitions of reality provided by legitimate authority. He describes this act of acceptance as an important component of obedience with moral consequences:

Every situation also possesses a kind of ideology, which we call the “definition of the situation,” and which is the interpretation of the

107. This additional hypothetical is included in Zimbardo & Leippe, *supra* note 40, at 73.

108. *See id.*

109. *Id.* at 74.

110. Miller, *supra* note 53, at 223. Milgram focused on the “legitimate” nature of his experimenter, although others have argued that, for example, perceived “greater expertise” was the driving force behind subjects’ obedience. But the “trusting the expert” explanation fails to adequately account for subjects’ behavior in one experimental variation where the experimenter gives his orders from another room and, thus, cannot see what level of shock the teacher is actually administering. In this version, compliance drops drastically. *See* Milgram, *supra* note 2, at 65-66. As nicely put by David Luban, the experimenter’s “superior knowledge is no different than if he was standing directly behind the teacher.” Luban, *supra* note 40, at 101. For a summary of the various aspects of the nature of authority, see Thomas Blass, *The Milgram Paradigm After 35 Years: Some Things We Now Know About Obedience to Authority*, in *Obedience to Authority: Current Perspectives on the Milgram Paradigm* 35, 41-44 (Thomas Blass ed., 2000).

111. Blass, *supra* note 110, at 38-41 (noting Milgram’s position on the nature of the authority).

112. Miller, *supra* note 53, at 223.

113. *See id.* (summarizing Damico’s view of Milgram’s contributions); Milgram, *supra* note 2, at 72 (noting that, for some subjects, “obedient dispositions are deeply ingrained”).

114. Miller, *supra* note 53, at 226.

meaning of a social occasion An act viewed in one perspective may seem heinous; the same action viewed in another perspective seems fully warranted. *There is a propensity for people to accept definitions of action provided by legitimate authority.*

. . . It is this ideological abrogation to the authority that constitutes the principal cognitive basis of obedience. If, after all, the world or the situation is as the authority defines it, a certain set of actions follows logically.¹¹⁵

Management creates the reality for inside counsel. Management defines objectives, identifies specific responsibilities for inside lawyers, and determines whether an inside lawyer's performance is acceptable.¹¹⁶ Management is vested with the authority to speak on behalf of the organization and is entrusted to give direction to inside counsel.

Obedience of the kind encountered in Milgram's experiments has implicit "contractual" elements as well.¹¹⁷ We are socialized to fulfill our end of the bargain and to avoid awkward or embarrassing disruptions of well-defined social scripts. Milgram's subjects felt an obligation to complete their role in the experiment. Leaving would involve "making a scene" and reneging on a commitment.¹¹⁸ As A.G. Miller notes, "Having volunteered to participate and having entered the laboratory, the subject is in a sense 'locked' into what will transpire there. It is normative to play out the part, to see things through."¹¹⁹

If such obedience pressures are encountered in a single experimental interaction with a total stranger, consider what pressures exist for inside

115. Milgram, *supra* note 40, at 145. The second part of Milgram's theoretical explanation, known as his theory of the "agentic" state, is much more controversial. See Miller, *supra* note 53, at 233-38 (evaluating empirical evidence for Milgram's theory of the shift into the "agentic state"). Milgram argued that obedient subjects enter into a different experiential state—the agentic state—that enables them to relinquish ultimate moral responsibility to the authority and follow his orders. See Milgram, *supra* note 40, at 145-46. For an overview of critiques of Milgram's experiments, see Miller, *supra* note 53, at 139-78, 221-55; Blass, *supra* note 110, at 35-59.

116. Jill E. Fisch & Kenneth M. Rosen, *Is There a Role for Lawyers in Preventing Future Enrons?*, 48 Vill. L. Rev. 1097, 1123 (2003).

117. Lee Ross & Richard E. Nisbett, *The Person and the Situation* 56 (1991) (noting the "implicit contract" elements of the Milgram experiments); see also Miller, *supra* note 53, at 229. But a contractual analysis of Milgram's experiments cannot be taken too far. Although many subjects insisted that they went along with the experiment because the learner had consented, a variation run by Milgram casts doubt on those post hoc explanations. In the variation, the learner expressly reserved the right to back out of the experiment whenever he wanted. Even under those circumstances, "[forty] percent of the subjects followed the experimenter's instructions to the bitter end despite the learner's protests; and three-fourths of the subjects proceeded long past the point where the learner withdrew his consent." Luban, *supra* note 40, at 98.

118. Miller, *supra* note 53, at 229.

119. *Id.* at 225.

counsel who face management and their commands day-to-day.¹²⁰ Unlike outside lawyers, inside lawyers have a “psychological contract” with management that is more “relational” than “transactional” because of the continuing nature of their role as long-term or indefinite-term employees or subordinates.¹²¹

I do not mean to exaggerate the nature and impact of obedience pressures applied to employees by their bosses. As Milgram discovered, some will refuse to obey immoral commands.¹²² Because one-third of subjects did not comply to the end, Milgram’s findings hardly support the hypothesis of irresistible compulsion.¹²³ But we should not be cavalier and dismiss obedience pressures experienced by corporate employees as *de minimis*. Also, I do not assert that obedience is inherently blind or slavish. In Milgram’s experiments, many subjects did question the experimenter’s wisdom in continuing, urged the experimenter to check on the learner’s condition, or expressed the resolve not to continue, while continuing to flip the switches.¹²⁴ These subjects were not blindly obeying the experimenter’s commands; they were seriously conflicted but unable to transform an intellectual, moral conviction into action.¹²⁵ As noted by Lee Ross, “[T]he Milgram experiments ultimately may have less to say about ‘destructive obedience’ than about ineffectual, and indecisive, disobedience.”¹²⁶

120. Although some still question whether the destructive behavior observed by Milgram in his laboratory is of the same genre as that found in the real world, his research evokes skepticism regarding the human condition. See Milgram, *supra* note 2, at 57-76.

121. The “psychological contract” is, according to one definition, the “sum of mutual expectations between the organization and the employee.” See Neil Anderson & Rene Schalk, *The Psychological Contract in Retrospect and Prospect*, 19 J. Org. Behav. 637, 638 (1998) (citations omitted). The concept encompasses both explicit and implicit, unspoken expectations, some more conscious (e.g., expectations with respect to salary) and less conscious (e.g., longer-term promotion prospects). *Id.* at 637-38. For purposes of this Article, the important point is that the contents and status of the psychological contract (i.e., whether the “contract” has been violated) is an important determinant of employee behavior and attitude. The difference between “transactional” and “relational” psychological contracts arises out of four dimensions with respect to the focus of the contract: time frame, stability, scope, and tangibility. In general, relational contracts are more flexible and dynamic, with less demarcated boundaries, and are more likely to involve aspects of the employee’s private lives. Transactional contracts are more inflexible and boundaries are clearer. *Id.* at 640-41.

122. In Milgram’s baseline experiment, twenty-six subjects obeyed the experimenter until the end. Fourteen, however, ultimately defied in spite of the experimenter’s protestations. Milgram, *supra* note 40, at 33. What accounts for the varying levels of obedience across a single experimental variation? We do not know. Personality, political persuasion, home environment, cultural or social background, and prior familiarity with the Nuremberg trials may all have played a role in the varying levels of obedience.

123. Luban, *supra* note 40, at 114.

124. See Ross & Nisbett, *supra* note 117, at 57.

125. Milgram, *supra* note 40, at 148.

126. See Ross & Nisbett, *supra* note 117, at 57.

b. *Threatened Self-Interest*

Mark Belnick's compensation was at the heart of the prosecution's case. In addition to his lavish salary, he had received a \$17 million bonus for the successful handling of an SEC inquiry (as his defense lawyer argued) and \$14 million in interest-free employee "relocation" loans to renovate a \$2.8 million Manhattan apartment and buy a \$10 million luxury home in Park City, Utah (where Tyco had no office).¹²⁷ The prosecutor accused Belnick of abandoning "everything his training, education and prior experience had taught him" in pursuit of the riches dangled before him by former CEO Kozlowski.¹²⁸ Assistant District Attorney Amy Schwartz, in the prosecution's opening statement, said that "[h]e was that much in Dennis Kozlowski's pocket, bought and paid for."¹²⁹

Although Belnick's defense team successfully created reasonable doubt in the prosecution's claim of overt greed and corruption, I suspect that there was some truth, albeit more subtle, to the prosecution's picture. Lawyers, like everyone else, are motivated by self-interest.

Of course, outside counsel too are motivated by financial self-interest. They have a personal, pecuniary interest in currying favor with senior managers by facilitating corporate transactions that generate legal fees, even if the transaction is not wealth-enhancing for corporate shareholders.¹³⁰ It is well-known, for example, that its largest client, Enron, represented seven percent of Vinson & Elkins's total annual revenues.¹³¹ But for inside counsel, as employees of the firm, the economic pressures are not just greater in degree, but also different in kind.

First, inside counsel are necessarily economically dependent on a single client. If they get fired, they lose their entire income, their insurance, and their basic livelihood. If pensions or stock options¹³² have not vested,¹³³

127. See Bilodeau, *supra* note 33. The relocation loan program was designed to assist employees who moved from Tyco's New Hampshire offices to its New York offices.

128. Lin, *Trial Under Way*, *supra* note 25, at 1.

129. Lin, *supra* note 22, at 18.

130. Rutherford B. Campbell, Jr. & Eugene R. Gaetke, *The Ethical Obligation of Transactional Lawyers to Act as Gatekeepers*, 56 Rutgers L. Rev. 9, 38-39 (2003).

131. See Michael C. Bender, *Lawmakers Accuse Enron Lawyers of Hiding Employee's Claims*, Austin Am. Statesman, Mar. 15, 2002, at D1 (noting that Vinson & Elkins billed Enron for \$36 million over the prior year).

132. Corporations are increasingly offering stock or stock options as compensation or bonuses, and they often make the corporate stock a central feature of the employee retirement plan. This has been justified as both a recruitment device for getting highly qualified lawyers from private practice and as an efficient performance incentive. John S. Dzienkowski & Robert J. Peroni, *The Decline in Lawyer Independence: Lawyer Equity Investments in Clients*, 81 Tex. L. Rev. 405, 517 (2002).

133. Employee stock options are usually given to the inside lawyer with a staggered vesting schedule, sometimes over a period of as much as five years. When inside lawyers are faced with the corporate misconduct of the co-agent to whom they directly or indirectly report, it is easy to see why they might prefer silence over disclosure. Retaliation by management in the form of termination could mean the forfeiture of an enormous amount of personal wealth.

then enormous sums of money can be forfeited as well. Even worse, if they get fired for whistle-blowing, they may get blacklisted¹³⁴—without recourse under the law to sue for retaliatory discharge.¹³⁵

Second, even if getting fired is not likely, inside counsel feels unrelenting pressure to justify herself and her department as a corporate cost center. In today's competitive and profit-oriented environment, no position feels completely secure, and the case that an adequate return on firm investment is being achieved must always be made. The best way to do so is to facilitate, not interfere with, corporate transactions favored by management.

Third, pleasing management can produce bigger bonuses, which have become a growing fraction of the total salary. As Patricia Hewlin has argued, the "degree to which organizations base rewards on subjective appraisals of performance will influence the degree to which employees experience dilemmas of choosing how or how not to behave when their values differ from those of the organization."¹³⁶ As subjectivity increases, the general counsel will more likely feel pressured to conceal her personal or ethical values that differ from organizational values. In addition to routine annual "bonuses," there may be other opportunities to be rewarded for pleasing management. For example, Kristina Mordaunt, Enron's inside counsel, not only facilitated some of the more controversial transactions, but also greatly profited from her personal investments in one of Enron's special purpose entities.¹³⁷

Finally, if the inside lawyer owns stock in the firm, then it may be in her self-interest not to do anything that might send the stock price into a tailspin. As shareholder, the lawyer's primary (and therefore superseding) objective becomes to maximize the value of the equity investment. This shareholder wealth maximization norm can compete with the lawyer's fiduciary duty to the corporation.¹³⁸ One could argue that equity-based

134. As observed by Geoffrey Hazard, there are senior corporate officers who "do not care about complying with the law or who feel that they cannot afford to do so. Many of them will not hesitate in firing a lawyer who gives them a hard time and then bad-mouthing the lawyer afterward. No system of rules can eliminate that risk." Hazard, *supra* note 87, at 1015-16.

135. For a discussion of inside counsel's right to sue under the tort of retaliatory discharge, see *infra* Part IV.B (discussing whistle-blower protections).

136. Patricia Faison Hewlin, Note, *And the Award for Best Actor Goes to . . . : Facades of Conformity in Organizational Settings*, 28 Acad. Mgmt. Rev. 633, 637 (2003).

137. Mordaunt reportedly received over \$1 million in return for a \$5800 investment. She made the investment without obtaining the consent of Enron's Chairman and CEO, in violation of Enron's Code of Conduct. Batson Report Appendix C, *supra* note 3, at 121-22, 193-94.

138. Dzienkowski & Peroni, *supra* note 132, at 520. But it would be simplistic to characterize this shareholder objective to maximize the value of the equity investment in solely self-serving terms. Studies of companies that have suffered because of unreasonable legal or economic risks taken by their employees generally show a mix of motivations. See, e.g., Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. Ill. L. Rev. 691, 726 (concluding, based on the evidence, that most fraud-on-the-market cases do not involve managerial self-dealing, but

compensation provides incentives to be honest, since fraud should be discovered in the long run.¹³⁹ But it is not clear that this is even true in the long run.¹⁴⁰ In the short term, it may well be in inside counsel's self-interest to misrepresent the company's financial condition in public filings—for example, by postponing the disclosure of an adverse financial development until the next quarter (after she quickly liquidates her investment), or by understating adverse items that a reasonably prudent securities lawyer would more fully disclose.¹⁴¹

Although equity ownership by lawyers raises a plethora of ethical issues, at this time there are no federal securities regulations or state ethics rulings or opinions that would bar lawyers from owning equity interests in their clients, even if the legal representation entails securities law matters.¹⁴² Since Enron, some legal academics have publicly chimed in on the issue of compensation practices for lawyers, arguing that equity compensation for lawyers, including inside lawyers, should be scrutinized.¹⁴³

What Belnick did with his Tyco stock options is telling. Although the grant of stock and options to Belnick were to enable him to “build significant equity” in Tyco, “Belnick regularly abandoned his investment in the Company and sold his shares (or converted options and sold the

rather attempts to conceal adverse business developments by senior managers, who think they can turn the company around under extreme circumstances); Langevoort, *supra* note 36, at 296-97 (providing examples of situations showing a mix of motivations).

139. Arlen & Carney, *supra* note 138, at 701, 727 (noting that only eleven percent of detected frauds went undiscovered for three years or longer).

140. We do not have data on frauds which go undetected. *Id.* at 726.

141. See Dzienkowski & Peroni, *supra* note 132, at 523 (noting the temptation to understate adverse items). It is worth noting that, although there is potentially enormous pecuniary gain for managers (including lawyers) to engage in insider trading (trading stock in advance of a market movement and deferring disclosure until after the informational advantage is fully exploited), most known attorney violations of securities laws relate to “issuer financial disclosure” and “securities offerings.” See Sec. & Exch. Comm’n, Section 703 of the Sarbanes-Oxley Act of 2002, Study and Report on Violations by Securities Professionals, app. A, at 2 (Jan. 24, 2003) (Classifications by Securities Professionals), available at <http://www.sec.gov/news/studies/sox703report.pdf> (noting that, of forty-nine violations by attorneys, only two relate to insider trading).

142. Dzienkowski & Peroni, *supra* note 132, at 413, 478. Beginning in 1995, several bar associations, ultimately including the American Bar Association (“ABA”) in 2000, issued ethics opinions that basically endorsed lawyers obtaining equity interests in their clients, subject to a few exceptions and requirements. See ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 00-418 (2000). But see ABA Task Force on Corp. Responsibility, *Preliminary Report of the American Bar Association Task Force on Corporate Responsibility July 16, 2002*, 58 Bus. Law. 189, 212-13 (2002) [hereinafter *ABA Preliminary Report*] (noting that “accepting securities in a client company in exchange for legal services . . . raise[s] potential conflicts of interest with the client and may adversely affect the attorney’s independence and judgment”).

143. “In a Sept[ember] 10 letter to Michael Eisenberg, the SEC’s deputy general counsel, [P]rofessor Richard Painter . . . suggest[ed] that the agency should examine ‘conflicts created by unorthodox methods of compensating lawyers’” Otis Bilodeau, *After Tyco, GCs Role Under Scrutiny*, Legal Times, Sept. 26, 2002, at 1. Susan Koniak notes that stock options “‘push GCs toward the measurable’—work that clearly impacts company profitability—and away from ‘work that makes the company healthy and not corrupt.’” *Id.*

underlying shares) within days after they vested, earning him millions of dollars.”¹⁴⁴ Some believe this is circumstantial evidence of his concealed knowledge that the stock price was artificially inflated. Or perhaps he just knew that his Tyco days were numbered.

* * *

In contrast to outside counsel, inside counsel is a mere employee. Obedience pressures in the firm context will be substantial, so we should not be surprised by the banal tendency to listen to superiors. Also, given the stark financial self-interest, which is threatened by asking too many questions or being viewed as obstructionist, we should not be surprised that inside counsel regularly succumbs to the situation.¹⁴⁵

2. Faithful Agent

a. *Alignment Pressures*

Above, I argued that the inside lawyer is a mere employee. But, far from being ordinary, the lawyer is a particular type of employee whose fundamental self-conception is that of faithful agent of the firm. This agency relationship is another crucial feature of the ethical ecology. Like all agents, the lawyer has to justify her behavior to her client, which creates pressures to align her views with those of her client. This alignment pressure can distort the lawyer’s judgments. How warped her judgments are depends on how closely aligned she feels with her client. How closely aligned she feels depends, in part, on her self-conceptualization of her role. Lawyers can be professionally molded to accommodate various conceptions of lawyering, with some conceptions creating greater alignment pressures toward clients than others. The effect of all these alignment pressures is that lawyers’ ethical judgments will sway in the client’s favor.

As a threshold matter, we should be clear who the client is. Formally, the client is the organization, not its “constituents,”¹⁴⁶ such as the board, the entity’s other employees or co-agents, or even the shareholders. Of course, the organization is entirely fictitious and can only act through the flesh and blood of its constituents. Therefore, in practice, the inside lawyer suspends this fiction and interacts with senior management (who are vested with the authority to direct her activities) as her de facto client or principal, although they are merely co-agents. Both outside and inside lawyers refer to and think of these co-agents as “clients,”¹⁴⁷ and the Model Rules strongly

144. Press Release, Tyco International, Ltd., *supra* note 32.

145. Part II.B, *infra*, explains in greater detail the mechanisms by which these pressures translate into unethical action.

146. Hazard, *supra* note 87, at 1013.

147. This tendency to conflate the corporate client with management is clearly demonstrated in a statement made by the General Counsel of ACC: “[W]e now have

support the identification of senior managers as the lawyer's de facto clients.¹⁴⁸ Also, with the exception of independent counsel,¹⁴⁹ all inside lawyers report, either directly or indirectly, to these co-agents. This mismatch between the beneficiary of the lawyer's fiduciary duty (the corporation) and the beneficiary of the lawyer's reporting duty (management) is inherently problematic for the state of professional norms.

Auditing vignettes study. Now consider recent research on the impact of roles on the judgments of professional auditors.¹⁵⁰ Don Moore, George Loewenstein, Lloyd Tanlu, and Max Bazerman surveyed 139 auditors employed full-time by one of the Big Four U.S. accounting firms.¹⁵¹ Each participant was given five intentionally ambiguous auditing vignettes¹⁵² and asked to judge the accounting for each. Half the participants were asked to assume that they had been retained by the firm they were auditing; the rest were asked to assume that they had been retained by an outside investor that was considering investing money in the firm. The firm's unaudited financial statements needed to be evaluated by all participants.

For all five vignettes, the auditors were on average about thirty percent more likely to find that the accounting behind a company's financial reports complied with Generally Accepted Accounting Principles ("GAAP") if they

lawyers who do not represent the clients that they are retained by, but who represent the public. That is the definition of a prosecutor or a policeman—not the definition of a corporate lawyer." Panel, *Ethical Dilemmas*, *supra* note 16, at 669; *see also*, Nelson & Nielsen, *supra* note 96, at 463 (noting that, "[i]n many interviews, the corporate counsel refer to various businesspeople and business units within their corporation as their 'clients,' even though technically both lawyers and the business personnel are employees of the same organization").

148. *See* Stephen M. Bainbridge & Christina J. Johnson, *Managerialism, Legal Ethics, and Sarbanes-Oxley Section 307*, 2004 Mich. St. L. Rev. 299, 308-10 (criticizing the pre-2003 Model Rules as contributing to lawyers' alignment with management even in the face of managerial misconduct). A recent survey of inside counsel revealed that at least twenty percent felt that their company's culture emphasized that senior management was the client. Chad R. Brown, *In-House Counsel Responsibilities in the Post-Enron Environment*, ACCA Docket, May 2003, at 96-97 (reporting the results of ACC's survey of 1216 members, who are all inside counsel). The survey was conducted in 2002 by Widmeyer Research and Polling for the ACC. Press Release, Ass'n of Corporate Counsel, In-house Counsel Poll on Corporate Scandals (Oct. 21, 2002), *available at* http://www.acca.com/about/press/item.php?key=20021021_15263.

149. Independent counsel is often retained by the Board of Directors.

150. Don A. Moore et al., *Conflict of Interest and the Unconscious Intrusion of Bias* (Harvard Negotiations, Orgs., and Mkts. Unit, Working Paper No. 02-40, 2002) [hereinafter Moore et al., *Unconscious Intrusion of Bias*]. This study is also referenced by Max H. Bazerman, George Loewenstein, and Don A. Moore in their article *Why Good Accountants Do Bad Audits*, Harv. Bus. Rev., Nov. 2002, at 97, 100.

151. The average age of the participants was twenty-nine, with an average of five years working as an auditor. Apparently, neither age nor years of auditing experience affected the results. Moore et al., *Unconscious Intrusion of Bias*, *supra* note 150, at 12.

152. Each vignette depicted a situation in which the accounting issues are not clearly addressed by current rule-based accounting standards. The issues included the recognition of intangible assets on the financial statements, the restructuring of debt with dilutive securities, the recognition versus deferral of revenues, capitalization versus expensing of expenditures, and the treatment of research and development costs on the financial statements. *See id.* at 11.

were playing the role of auditor for that firm (as opposed to representing the potential investor), demonstrating substantial bias in auditors' judgments when asked to suppose a hypothetical role with a client.¹⁵³ If a mere hypothetical relationship with a client could generate such great distortions in auditing judgment,¹⁵⁴ one can only imagine the degree of distortion that might exist in a longstanding relationship between a lawyer (acting in her capacity as faithful agent) and her de facto client.

Accountability. Why were the judgments of the firm's auditors so grossly distorted in favor of their client? The authors of the auditing vignettes study explain these results by focusing on the mechanism of "accountability" in the agent-principal relationship.¹⁵⁵ Accountability—having to justify one's views to others—is at the crux of the relationship. Agents are, by definition, accountable to their principals; they must justify their actions and views to their principals. Accountants and lawyers, as agents, must justify their views and decisions to management in terms that management understands and values.

Accountability can thus produce a chameleon-like shift in behavior in the principal's direction. Other studies have demonstrated that even a weak form of accountability between strangers can bias subjects in adopting public positions that are more closely aligned with the preferences of those to whom they are accountable.¹⁵⁶ If we know we are speaking before a bunch of liberals, we perform more liberal talk; in front of conservatives, we talk conservatively.

Accountability may produce an even deeper alignment. In a follow-up study, Don A. Moore et al. found that role manipulation—that is, whether the subject worked as "auditor" for either the seller or buyer—had a significant effect in aligning private beliefs about the client's accounting in favor of their hypothetical client.¹⁵⁷ In other words, affiliated agents tend to automatically adopt the principal's perspective of the world, which is a "partisan point of view." Moreover, once the agent adopts a partisan

153. *Id.* at 13.

154. *Id.* at 14 (noting that a possible explanation for the substantial effect derived from a weak manipulation is that "participants were familiar with the role of auditor, and so were able to easily put themselves in the role of being employed by, and accountable to, the client firm").

155. *See id.* at 5.

156. Philip E. Tetlock, *The Impact of Accountability on Judgment and Choice: Toward a Social Contingency Model*, 25 *Advances in Experimental Soc. Psychol.* 331, 341, 343 (1992) (noting that "subjects accountable to a liberal audience expressed more liberal views whereas subjects accountable to a conservative audience expressed more conservative ones"); *see also* Don A. Moore et al., *Conflicts of Interest and the Case of Auditor Independence: Moral Seduction and Strategic Issue Cycling* 21 (Harvard Bus. Sch., Working Paper No. 03115, 2005), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=667363 (noting that, in a pre-decisional setting, accountability demands strategic attitude shifting—which need not be conscious).

157. Moore et al., *Unconscious Intrusion of Bias*, *supra* note 150, at 19 (noting that auditors working for the seller reported the company to be more valuable than did auditors working for the buyer).

affiliation with the principal, “it can be difficult if not impossible to undo that encoding or to retrieve unbiased information from memory.”¹⁵⁸

Strength of accountability. As explained above, an agent’s accountability to her principal produces alignment. It is reasonable to suppose that the stronger the accountability, for whatever reasons, the greater the alignment. What accounts for the strength of accountability? There are multiple binding factors that determine the strength of the agency relationship. Many of these factors are ones already identified as inherent in the “mere employee” relationship. For example, stark financial ties to the principal will increase accountability to the principal.¹⁵⁹ Evidence now suggests that social ties also have that effect.¹⁶⁰ Given the day-to-day social interaction between management and inside counsel, this is another reason why accountability to management should be strong.

In addition, the characteristic activities of lawyering may also contribute to the strength of accountability. As Gerald Postema argues, unlike the physician or auto mechanic, the lawyer “act[s] in the place of the client, [which] require[s] the direct involvement of the lawyer’s moral faculties—i.e., his capacities to deliberate, reason, argue, and act in the public arena.”¹⁶¹ As the client’s agent, the lawyer speaks on behalf of the client and enters into relationships with others in the name of the client.¹⁶² What the lawyer does is typically attributable to the client.¹⁶³ “Thus, at the invitation of the client, the lawyer becomes an extension of the legal, and to an extent the moral, personality of the client.”¹⁶⁴ Consistently acting out behavior may have far-reaching consequences. As cognitive dissonance theory predicts, our internal attitudes are likely to shift toward the position implied by our behavior, thereby making our behavior appear more justifiable.¹⁶⁵ Thus, it is entirely plausible, as Karl Llewellyn suggested, that the most powerful determinant of the attitudes and social orientation of lawyers is the work they do.¹⁶⁶

158. *Id.* at 27 (citation omitted); see also Linda Babcock et al., *Biased Judgments of Fairness in Bargaining*, 85 Am. Econ. Rev. 1337, 1342 (1995) (criticizing the “economic” view, held by Richard Posner, that information facilitates settlement because it should cause parties’ expectations to converge).

159. Moore et al., *Unconscious Intrusion of Bias*, *supra* note 150, at 21.

160. *Id.* at 27 (concluding that social ties between auditors and their clients may be more of a problem than financial incentives per se).

161. See Gerald J. Postema, *Moral Responsibility in Professional Ethics*, 55 N.Y.U. L. Rev. 63, 76 (1980). The first exposition of the role-differentiated morality of the lawyer-client relationship (the “amoral professional role”) was given by Richard Wasserstrom. See Richard Wasserstrom, *Lawyers as Professionals: Some Moral Issues*, 5 Hum. Rts. 1, 14 (1975), reprinted in *The Ethics of Lawyers* 16 (David Luban ed., 1994).

162. Postema, *supra* note 161, at 77.

163. *Id.*

164. *Id.*

165. Kunda, *supra* note 65, at 216-20, 533.

166. Robert L. Nelson, *Ideology, Practice, and Professional Autonomy: Social Values and Client Relationships in the Large Law Firm*, 37 Stan. L. Rev. 503, 527 (1985) (citing Karl Llewellyn, *The Bar Specializes—With What Result?*, 167 Annals Am. Acad. 177, 177 (1933)). Karl Llewellyn states,

b. Role Ideology

Another key variable in determining the strength of an agent's accountability to her principal is her understanding of the nature of her role as attorney and the ideological or normative commitments that such a role entails—role ideology.¹⁶⁷ Ideologies about the law come with their own particular normative vision of lawyering and the lawyer's role. Conversely, roles come “ready-made,” packaged by society,¹⁶⁸ with their own sets of ideologies or “normative guidelines and values that give meaning and shape behavior.”¹⁶⁹ Even an ideology that purports to view the lawyer's role in “morally neutral” or “agnostic” terms still makes a normative choice that we should view her role in such terms.

Role ideologies serve two functions. First, they constitute nontrivial *ex ante* situational influences that define the universe of socially acceptable norms for that role, to whom or what the lawyer is accountable, and what degree of alignment to (or independence from) the *de facto* principal is socially appropriate. When acting in accordance with a role, “one simply acts as others expect one to act.”¹⁷⁰ As put by Postema, “Although there is a personal or idiosyncratic element in any person's conception, nevertheless, because the role of lawyer is largely socially defined, significant public or shared elements are also involved.”¹⁷¹ Thus, socially defined role ideologies can lend ideological legitimation to a given style of lawyering (for example, lawyering based on “client supremacy”), making it a more palatable option.¹⁷² Over time, a lawyer may come to identify with a particular role ideology and come to believe that her unethical choices are in fact entirely consistent, and even possibly endorsed, by such role ideology.

Second, even if role ideologies do not have a significant *ex ante* situational influence on behavior in any given case, they can serve to legitimate any *post hoc* rationalizations of unethical behavior¹⁷³ by framing

Now, any man's interests, any man's outlook, are shaped in greatest part by what he *does*. . . . Hence the practice of corporation law not only works for business men toward business ends, but develops within itself a business point of view—toward the work to be done, toward the value of the work to the community, indeed, toward the way in which to do the work.

Id. (citing Llewellyn, *supra*, at 177).

167. The term “role ideology” is borrowed from “gender-role ideology” which refers to prescriptive beliefs about roles and behaviors for women and men, with the dimensions defined by “traditional” and “feminist” poles.

168. See Postema, *supra* note 161, at 74.

169. Hewlin, *supra* note 136, at 638.

170. See Postema, *supra* note 161, at 74.

171. See *id.* at 73 n.26.

172. Such a “choice” may not be a rational choice in the traditional sense. See my comments below in Part II.B.

173. In a *post-decisional* setting, accountability demands encourage *post-decisional* bolstering and the selective generation of reasons to justify what one has already done. Moore et al., *supra* note 156, at 21.

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the ethical problem in a manner that makes it more attractive to act unethically. Thus,

[b]y taking shelter in the role, the individual places the responsibility for all of his acts at the door of the institutional author of the role.

. . . For the person who [fully] identifies with [her] role, the response “because I am a lawyer,” or more generally “because that’s my job,” suffices as a complete answer to the question “why do that?”¹⁷⁴

This next step might be that rationalization transforms into real attitude change. Cognitive dissonance theory predicts that our internal attitudes are likely to shift toward the position implied by our actions.¹⁷⁵

In modern legal culture, various role ideologies are available.¹⁷⁶ At one extreme is the “officer of the court” view, the “grand Brandeisian vision of a public role for lawyers that contemplates a broader professional obligation than to act only in the client’s (or the lawyer’s) self-interest.”¹⁷⁷ Under this model, inside counsel, simply by virtue of being a lawyer, would be accountable, not only to her client or co-agent, but also to the public. In this world, the alignment generated by accountability to the de facto principal might be partial (at best), since lawyers would not only have to consider management’s (perhaps fraudulent) goals, but also the public welfare. Of course, outside of the legal academy, most lawyers do not live in this world.¹⁷⁸

At the other extreme, the lawyer’s role is shaped by a “law is the enemy” or “libertarian-antinomian” philosophy, which sees regulation contemptuously as nothing more than a tax on business, and a hindrance to the wheels of private commerce.¹⁷⁹ This view is reflected in President Ronald Reagan’s inaugural address statements: “[G]overnment is not the solution to our problem; government is the problem.”¹⁸⁰ At Enron, such a view was endorsed by management: Senior managers conducted a skit in which one of the themes was deceiving the SEC.¹⁸¹ Under this view, the

174. See Postema, *supra* note 161, at 74-75.

175. See Kunda, *supra* note 65, at 216-20, 533.

176. My summary of the various role ideologies borrows much from Robert W. Gordon. See Robert W. Gordon, *A New Role for Lawyers?: The Corporate Counselor After Enron*, 35 Conn. L. Rev. 1185, 1191-1207 (2003) (summarizing various views of the law and lawyers’ role).

177. See Gilson, *supra* note 80, at 871. The first sentence of the ABA’s Preamble to the Model Rules states that “[a] lawyer is a representative of clients, an officer of the legal system and a public citizen having special responsibility for the quality of justice.” Model Rules of Prof’l Conduct pmb1. (1998).

178. See Eugene R. Gaetke, *Lawyers as Officers of the Court*, 42 Vand. L. Rev. 39, 43-44 (1989) (arguing that the characterization of lawyers as officers of the court under contemporary law is largely disingenuous).

179. Gordon, *supra* note 176, at 1191.

180. Lou Cannon, *Clash of Temperament*, Smithsonian, Oct. 2004, at 63, 64.

181. Stephen M. Cutler, Dir., Div. of Enforcement, U.S. Sec. & Exch. Comm’n, Second Annual General Counsel Roundtable: Tone at the Top: Getting it Right (Dec. 3, 2004), available at <http://www.sec.gov/news/speech/spch120304smc.htm>.

lawyer's role is to assist the client in devising creative ways to circumvent the law, regardless of any harm to third parties or the underlying purposes of the law. As the view that is most hostile to law, the alignment to the de facto principal (who favors unlawful actions) would be strong.

In the middle, two agency-centered conceptions characterize how some inside lawyers view their role. One traditional conception of lawyering that has found tremendous longstanding support in the organized bar¹⁸² and the rules of professional ethics is that the lawyer should be committed to the "aggressive and single-minded pursuit of the client's objectives" within, but all the way up to, the limits of the law.¹⁸³ Her zealous advocacy should not be constrained by her own moral sentiments or commitments, but only by the "objective, identifiable bounds of the law."¹⁸⁴ Thus, under this model of partisan loyalty, the lawyer is instructed to interpret legal boundaries from the perspective of maximizing client interest.¹⁸⁵ In this client-centered world, the alignment to the de facto principal would also be strong.

Another middle-of-the-road ideology that most accurately reflects the type of lawyering that carries on day-to-day in corporate legal departments is the "agnostic" view that law is a "neutral constraint,"¹⁸⁶ and, accordingly, that the lawyer's role is that of an amoral risk assessor.¹⁸⁷ This view is characterized by the lack of moral imperative to comply with the law¹⁸⁸ and the lawyer's moral detachment from the law. The lawyer's role is

182. The conception of lawyering as "zealous advocacy" has been the basis for the organized bar's resistance to any change in the rules. *See* Gordon, *supra* note 176, at 1194.

183. *See* Model Code of Prof'l Responsibility Canon 7 (1980) ("A Lawyer Should Represent a Client Zealously Within the Bounds of the Law."); Postema, *supra* note 161, at 73.

184. This role ideology encourages, at the very least, a degree of ethical opportunism. *See* Stephen L. Pepper, *The Lawyer's Amoral Ethical Role: A Defense, a Problem, and Some Possibilities*, 1986 Am. B. Found. Res. J. 613, 614 (stating that the traditional and accepted standard within the legal profession is that "[a]s long as what lawyer and client do is lawful, it is the client who is morally accountable, not the lawyer"); David B. Wilkins, *Legal Realism for Lawyers*, 104 Harv. L. Rev. 468, 473, 505 (1990) (arguing that legal realism's indeterminacy thesis and traditional model of partisan loyalty effectively encourage the lawyer to exploit doctrinal gaps, conflicts, and ambiguities to the narrow advantage of their clients).

185. *See* Wilkins, *supra* note 184, at 473.

186. This view is captured well by a statement of one in-house lawyer:

Our job is to assess risks, and it's the businessperson's job to make decisions about risks, what risks they are willing to assume. Now, having said that, I also think of it as my job to make sure that the decision about what risks to assume is being made at the appropriate level.

Nelson & Nielsen, *supra* note 96, at 473.

187. Gordon, *supra* note 176, at 1192.

188. This lack of moral imperative is reflected in the comments of Professor (Judge) Frank Easterbrook and Professor Daniel Fischel regarding corporate law compliance: "Managers have no general obligation to avoid violating regulatory laws, when violations are profitable to the firm We put to one side laws concerning violence or other acts thought to be *malum in se*." Frank H. Easterbrook & Daniel R. Fischel, *Antitrust Suits by Targets of Tender Offers*, 80 Mich. L. Rev. 1155, 1168 n.36 (1982) (citations omitted). For a thorough summary and critique of this agnostic view of law, see Cynthia A. Williams, *Corporate Compliance with the Law in the Era of Efficiency*, 76 N.C. L. Rev. 1265 (1998).

diminished to that of a counselor who games the rules to work around the constraints and lower “tariffs” or “taxes” as much as possible.¹⁸⁹ While this view is not openly hostile to the law, it is not respectful of it either, and thus corrodes the legitimating force of the law. The lack of a moral imperative to observe the law means that noncompliance is a feasible, even reasonable, business option.

The actions of Nancy Temple, inside counsel at Arthur Andersen, exemplify the “agnostic” view of law. Although Temple was fully aware of an informal SEC investigation into Enron and a Vinson & Elkins investigation into Watkins’s allegations, she sent an e-mail to Arthur Andersen’s Houston practice director, reminding him to comply with their document retention policy.¹⁹⁰ As a result of her reminder, a significant number of documents relating to Enron were shredded. Unfortunately, it is “unlawful to destroy documents if they are subject to discovery or relevant to a ‘clearly foreseeable’ legal action.”¹⁹¹ The jury convicted Andersen of obstructing the SEC’s Enron investigation by destroying documents.¹⁹²

On the one hand, Temple’s advice seems unremarkable and in line with “the kind of advice that lawyers routinely give.”¹⁹³ On the other hand, the fact that it may be “routine” is problematic. Instead of urging her director to comply with the law and refrain from document destruction, she shows complete indifference to what he ultimately and actually decides to do with the evidence. It is no wonder that documents were shredded after her advice was given. Meanwhile, Temple escapes responsibility because her e-mail is carefully worded in a manner that does not explicitly counsel his breaking the law.

This “agnostic” view of the law has taken on a distinctly pro-business orientation, where “efficiency” (rather than “adversarialism”) is the paramount ideal of the profession.¹⁹⁴ As described by Mark Suchman, the “good lawyer provides a cost-effective vehicle for his or her client’s specific interests, and in doing so, he or she also facilitates the efficient

189. Gordon, *supra* note 176, at 1192.

190. The e-mail states, “It might be useful to consider reminding the engagement team of our documentation and retention policy. It will be helpful to make sure that we have complied with that policy.” E-mail from Nancy A. Temple, Counsel, Arthur Andersen, to Michael C. Odom, Audit Partner, Arthur Andersen (Oct. 12, 2001, 08:53 CST), *reprinted in Destruction of Enron-Related Documents by Andersen Personnel: Hearing Before the H. Reps. Comm. on Energy*, 107th Cong. 1, 45 (2002), available at <http://www.access.gpo.gov/congress/house/house05ch107.html>.

191. See Deborah L. Rhode & Paul D. Batton, *Lawyers, Ethics and Enron*, 8 Stan. J.L. Bus. & Fin. 9, 24 (2002).

192. For an in-depth account of the jury’s basis for conviction, and the prominent role of Nancy Temple in Arthur Andersen’s conviction, see Burton & Dzienkowski, *supra* note 7, at 692-711. The judgment was recently overturned by the U.S. Supreme Court. See James Vicini, *High Court Overturns Andersen’s Enron Conviction*, Reuters, May 31, 2005, available at http://www.ezilon.com/information/printer_5179.shtml.

193. Stephen Gillers, *The Flaw in the Andersen Verdict*, N.Y. Times, June 18, 2002, at A23.

194. See Suchman, *supra* note 97, at 871.

functioning of the economy as a whole.”¹⁹⁵ This view is exacerbated by the American Bar Association’s (“ABA”) official pronouncements that “lawyers serve the public best by serving the private interests of their clients with maximum zeal, in effect treating lawyers like Adam Smith’s tradesmen, who count on an invisible hand to transmute their pursuit of private advantage into a benefit for the community as a whole.”¹⁹⁶

As reported in an empirical study on inside counsel¹⁹⁷ performed by Robert Nelson and Laura Beth Nielsen,¹⁹⁸ many of the inside lawyers surveyed viewed the law as “a source of profits, an instrument to be used aggressively in the marketplace.”¹⁹⁹ They self-identified strongly with their role as company employees and only secondarily with the legal profession. These in-house legal “entrepreneurs”²⁰⁰ emphasized the business values in their work and embraced their mission, not just in providing high-quality legal advice, but in “adding value” to the firm. Like their business colleagues, they were “literally absorbed in a high-pressure corporate environment,”²⁰¹ as reflected in the corporate obsession with the bottom line.²⁰²

Robert Rosen has observed that, instead of being gatekeepers,²⁰³ some inside counsel have tailored their services to the operating rule: “[Y]ou will be employed by us as long as you add value to the organization, and you are continuously responsible for finding ways to add value.”²⁰⁴ And what could “adding value” mean? “Adding value” means that inside lawyers

195. *Id.*

196. Anthony T. Kronman, *The Law as a Profession, in Ethics in Practice: Lawyers’ Roles, Responsibilities, and Regulation* 29, 37 (Deborah L. Rhode ed., 2000).

197. Nelson and Nielsen interviewed fifty-four informants of twenty-two corporations, forty-two of whom are inside lawyers, and twelve of whom are nonlawyer managers. *See* Nelson & Nielsen, *supra* note 96, at 460-61.

198. A brief word about methodology. “Counsel” was treated as a default category. If the participant, during his interview, did not meet certain criteria specified for “cop” or “entrepreneur,” he was classified as “counsel.”

A [participant] was classified as a cop if he or she indicated that (a) they offered only legal advice and avoided giving business advice, (b) they played an active gatekeeping role (marked by an affirmative obligation to monitor compliance, the ability to say no to business clients, and the ability to go over the head of management), and that (c) they did not market the legal function within the corporation. A [participant] was coded as an entrepreneur if he or she (a) offered non-legal advice on business decisions, and (b) marketed the legal function.

Id. at 468.

199. *Id.* at 466. An example of lawyering in this vein might be an aggressive trademark litigation strategy where the company uses the lawyer’s services to sue small defendants on weak legal grounds, aiming to intimidate or outspend small defendants into forfeiting a valid trademark or trade name.

200. A significant minority (thirty-three percent) fit the definition of “entrepreneurs,” seeing themselves mainly as business persons. Not only did entrepreneurial lawyers outnumber cops by two to one, but also—based on the interviews—“the center of gravity within the counsel category [was] closer to entrepreneurs than to cops.” *Id.* at 469.

201. *Id.* at 490.

202. *Id.* at 472.

203. *See* Rosen, *supra* note 91, at 668.

204. *See id.* at 681.

must not be content with giving legal advice that merely tells the co-agent what is legally permissible.²⁰⁵ “Adding value” might include advice about how to circumvent inconvenient law, or at least doing everything possible to avoid telling the co-agent that he cannot do something simply because it is illegal.²⁰⁶ “Adding value” carries the view that corporate compliance is ultimately a “risk management” issue.²⁰⁷

These empirical findings suggest that the agnostic view of the law (with the focus on “adding value”) has become the dominant role ideology for inside counsel in the twenty-first century. This ideology is entirely consistent with the rhetoric of most business management.²⁰⁸ And, as Milgram showed, agents and subordinates readily accept the “definition of the situation” advanced by their de facto principals and superiors.²⁰⁹ Accepting management’s “definition of the situation” means accepting management’s framing of the inside lawyer’s role and responsibilities. What that often leads to is a segmentation of compliance responsibilities. Although inside counsel’s duties include a prominent role in corporate compliance, it is business management that guards the right to decide whether to comply with the law, which is seen as the ultimate risk-management decision.²¹⁰

205. Note the following excerpt from the 2004 ACC conference:

We must provide advice which anticipates and explains the “how to” of preferred alternatives rather than solely the rationales for “why not” for disfavored, illegal, or unethical courses of action And we must practice preventive law when counseling concerning the appropriate management [of] legal risk So we must learn from our experiences . . . and continue to rely on the processes and fundamentals that ensure that we are prepared for whatever may come, while gaining and carrying out our roles as key members of the corporate team.

Ass’n Corporate Counsel, The New Face of In-house Counsel, 2004 ACC Conference, <http://www.acca.com/am/04/> (last visited Oct. 21, 2004).

206. See *id.* The ACC’s statements are in sharp contrast to the view of a lawyer’s role by lawyer and statesman Elihu Root, who said, “[A]bout half the practice of a decent lawyer consists in telling would-be clients that they are damned fools and should stop.” 1 Philip C. Jessup, Elihu Root 133 (1938) (quoting Elihu Root).

207. Robert Rosen’s research on Enron and other “redesigned corporations” shows that compliance decisions are viewed as ultimate risk management decisions to be made by business executives. Lawyers are used by project teams as hired guns to assess legal risk and “think creatively.” The most crucial consequence is that noncompliance becomes an option. See Robert Eli Rosen, *Risk Management and Corporate Governance: The Case of Enron*, 35 Conn. L. Rev. 1157, 1169, 1172 (2003).

208. See, e.g., *id.* at 1169 (quoting a senior executive who stated that “[f]rom a [transactional] lawyer, what I want is quality of work: bringing up good issues and pertinent points to defend our side of the equation”); Rosen, *supra* note 91, at 661 (adopting a demand-side perspective and noting that corporate legal departments have been reengineered and, thus, transformed by organizational development consultants to mirror multidisciplinary practice firms).

209. See Nelson, *supra* note 166, at 527 (noting, based on empirical data gathered in a case study of four Chicago law firms, that lawyers come to adopt the positions of the corporate clients whom they represent).

210. See Rosen, *supra* note 207, at 1172.

While being morally detached from the co-agent's compliance decisions, the inside lawyer can still excel at being a legal technician.²¹¹ She can take tremendous pride in her craft, regardless of the ultimate purposes of the client. In a reverse Machiavellian sense, the means justify the ends. Potentially, this "moral independence"²¹² from her client psychologically relieves her of any felt responsibility to "follow up" on issues; she can just take management's word that "it will be taken care of." She punts it. That is what Donald M. Feuerstein, former CLO at Salomon Brothers, Inc., did when he failed to follow up on a number of false bids made by his company in an auction of U.S. treasury securities.²¹³ The lawyer feels she has satisfied her job duties by giving the correct legal advice, even though she may learn at the water cooler that, in fact, her advice was not taken. Now all that is left to do is to memorialize that advice to the recipient in an attorney-client privileged "CYA"²¹⁴ memorandum.

* * *

Compounded on top of obedience pressures, alignment pressures, mediated by the mechanism of accountability, have a distorting effect on the judgments and attitudes of inside lawyers. Social psychologist Philip Tetlock observes that "decision-makers can be no better as well as no worse than the constituencies to whom they are accountable."²¹⁵ Speaking about inside counsel, the same point is rephrased by Geoffrey Hazard, who notes with a tone of stark realism that "[c]orporate lawyers cannot be distinctly more virtuous than the corporate management by which they are employed."²¹⁶

211. Milgram observed the tendency of his subjects to become so consumed by the narrow technical aspects of the task that they lost sight of potential, broader consequences (e.g., the heart failure of the learner). Milgram, *supra* note 40, at 7. Gerald Postema also notes the relationship between moral detachment and becoming a "legal technician." Postema, *supra* note 161, at 80. Commenting on the Milgram experiments, J.P. Sabini and Maury Silver note that Milgram's subjects confused technical responsibility (that is, the experimenter's accountability for the conduct of the experiment itself) and moral responsibility. See Miller, *supra* note 53, at 187-88.

212. See Richard W. Painter, *The Moral Interdependence of Corporate Lawyers and Their Clients*, 67 S. Cal. L. Rev. 507 (1994) (noting that the combined principles of loyalty and moral independence permit lawyers to go to extremes on behalf of their clients and also grant lawyers the authority to set the only limits on those extremes).

213. See Gutfreund, Exchange Act Release No. 34-31554, 52 SEC 93 (Dec. 3, 1992). In a report that sets forth the SEC's views on the responsibilities of lawyers and compliance officers, the SEC stated that Feuerstein was "obligated to take affirmative steps to ensure" that misconduct was adequately addressed. *Id.* at 113. Such steps might include "disclosure of the matter to the entity's board of directors, resignation from [the representation], or disclosure to regulatory authorities." *Id.* at 114. In this case, the SEC demanded of Feuerstein an obligation that was not expressly required by the Model Rules.

214. "Cover your ass."

215. Tetlock, *supra* note 156, at 349.

216. Hazard, *supra* note 87, at 1017. Although "virtue" is literally a dispositional quality, in this statement, Professor Hazard demonstrates his sophisticated understanding of the situational context of inside counsel.

3. Team Player

a. *Conformity Pressures*

The above situational characteristics, of employee and agent status, emphasized the consequences of vertical hierarchy. But the inside lawyer is not only an employee or faithful agent, but also a “team player,” a loyal member of the corporate club. As such, horizontal social pressures further incline the countenancing of unethical behavior.

In July 2000, when the U.S. Consumer Product Safety Commission had tentatively approved a recall plan of defective sprinkler systems manufactured by a Tyco subsidiary, Belnick wisely recommended that Tyco offer consumers replacements for faulty sprinkler heads.²¹⁷ But to Belnick’s surprise, CEO Kozlowski accused Belnick of intentionally siding with the government: “Do you work for the government? Or Tyco?”²¹⁸ In chiding Belnick, Kozlowski questioned Belnick’s loyalty to the corporate team and his fitness as a corporate citizen. Serving the company meant not conceding to government’s wishes—even if doing so would be good and fair to consumers and the long-term interest of Tyco. After all, in Kozlowski’s view, the government is the enemy. Kozlowski’s “us vs. them” mentality left very little to the ethical discretion of the general counsel.

In addition to obedience and alignment pressures, Belnick was subject to considerable conformity pressures that arise from personal relationships with colleagues and peers. “Conformity” is “a change in belief or behavior in response to real or imagined group pressure when there is no direct request to comply with the group nor any reasons given to justify the behavior change.”²¹⁹ Although Kozlowski’s demand for “take no prisoners” loyalty was rather explicit, he implicitly appealed to Belnick’s social identity with a particular group—the corporate team at Tyco. Research on conformity confirms the enormous power of these group pressures.

Half a century ago, Solomon Asch conducted a series of experiments intended to demonstrate that conformity to the opinions of strangers is not likely if the judgment stimulus is straightforward and unambiguous.²²⁰ Asch recruited male college students for the stated purpose of participating in an “experiment on visual judgment.”²²¹ Participating in groups of seven

217. Miriam Rozen, *Losing it All*, Corp. Counsel, Feb. 2003, at 66, 70.

218. *Id.* at 70.

219. Zimbardo & Leippe, *supra* note 40, at 55.

220. Ross & Nisbett, *supra* note 117, at 31 (noting Asch’s initial expectation that the vast majority of his subjects would remain independent in the face of the unanimous majority); Zimbardo & Leippe, *supra* note 40, at 56.

221. This summary of the Asch study is compiled from Solomon E. Asch, *Social Psychology* 450-59 (1952) [hereinafter Asch, *Social Psychology*]; Ross & Nisbett, *supra* note 117, at 30-35; Zimbardo & Leippe, *supra* note 40, at 56; Solomon E. Asch, *Studies of*

to nine persons, they were asked to use their independent judgment and indicate which of three “comparison” lines displayed on one card (at the front of the classroom) matched the length of a so-called “standard” line displayed on another card. All but one of the students were confederates of the experimenter who announced their answers according to a prearranged script. The sole real subject was nearly always seated in the next-to-last seat and, thus, announced his judgment after hearing most of the confederates’ answers. On certain key trials, the confederates all chose the same wrong line. When faced with this obvious discrepancy between the evidence of his own senses and the divergent group consensus, how did the subject react?

Notwithstanding the simple and objective nature of this task, one-third of the answers in the key trials of Asch’s baseline experiment²²² were wrong and in line with those of the confederates, in contrast to a control group whose judgments (made privately in writing) were “virtually free of error.”²²³ Only one-fifth of subjects never conformed and consistently remained independent in face of group pressures.²²⁴

Although Asch maintained that his experiments investigated the conditions for both independence and lack of independence amidst group pressure,²²⁵ what has captured the fascination of most psychologists is the stunning finding that, at least for a minority of subjects, a group norm can influence behavior, even in the face of clear, objective standards.²²⁶ Group consensus is a powerful facet of the situation, and the observed tendency to reach agreement with the group is a “dynamic requirement of the situation,” to use Asch’s words.²²⁷ To be clear, this is not to say that “people are sheep,”²²⁸ although one subject did describe his actions as a product of

Independence and Conformity, 70 Psychol. Monographs: Gen. and Applied 1 (1956) [hereinafter Asch, *Studies of Independence*].

222. Asch, *Studies on Independence*, *supra* note 221, at 9 (noting that the proportion of errors was less than one percent of the total number of critical estimates). Data reported relate solely to Asch’s baseline experiment, which Asch calls “Experiment I.” Asch, *Social Psychology*, *supra* note 221, at 457.

223. Asch, *Social Psychology*, *supra* note 221, at 457 tbl.II; Asch, *Studies on Independence*, *supra* note 221, at 9.

224. Asch, *Social Psychology*, *supra* note 221, at 458.

225. Asch notes that “[i]t is consequently unduly narrowing to emphasize submission, to the neglect of the not inconsiderable powers persons demonstrate on occasion for acting according to conviction and rising above group passion.” Asch, *Studies of Independence*, *supra* note 221, at 3.

226. Asch, *Social Psychology*, *supra* note 221, at 483 (noting that “[i]n different ways and with different strengths the situations studied showed a ‘pull toward the group’; changes of estimation went overwhelmingly in the majority direction”); Zimbardo & Leippe, *supra* note 40, at 57; *see also* Ronald Friend, Yvonne Rafferty & Dana Bramel, *A Puzzling Misinterpretation of the Asch ‘Conformity’ Study*, 20 Eur. J. Soc. Psychol. 29 (1990) (arguing that psychologists have mistakenly and increasingly accentuated the role of conformity and underestimated that of independence in interpreting Asch’s findings).

227. Asch, *Social Psychology*, *supra* note 221, at 484.

228. *See* Ross & Nisbett, *supra* note 117, at 33 (noting that the “people are sheep” characterization illustrates the fundamental attribution error). Asch asserted that this

“sheer force of habit.”²²⁹ Many more subjects experienced deep “perplexity and bewilderment” when encountering a group’s firm but erroneous judgments.²³⁰

The motivations underlying conformity are many. For purposes of this Article, I would like to focus on the one that is systematically underappreciated: the normal desire to avoid the stigma of dissenting from the group.²³¹ Asch’s post-experimental interviews with the subjects reveal that, even for those subjects who consistently remained independent, the threat of being stigmatized as a dissident loomed large. The following examples of subjects’ self-reports were typical of many reactions:

“I felt like a Malik or Molotov The stigma of being a nonconformist—being stubborn.”²³²

“[It] would be amusing if I turned out to be right, but if wrong, sort of lonely feeling.”²³³

“I felt the need to conform Mob psychology builds up on you. It was more pleasant to agree than to disagree.”²³⁴

“We all want to be with the bandwagon.”²³⁵

“They were strangers. It was like being in a strange country. ‘When in Rome you do as the Romans.’”²³⁶

“striving to come nearer to the group” was “far from having its origin in blindly imitative tendencies.” Asch, *Social Psychology*, *supra* note 221, at 484.

229. Asch, *Studies on Independence*, *supra* note 221, at 41.

230. Asch, *Social Psychology*, *supra* note 221, at 454. Some subjects fidgeted in their seats, turned around, whispered to their neighbors, smiled sheepishly, or stood up to look more closely at the cards. *Id.*

231. Asch concluded that one of the underlying motivations for subjects’ conforming behavior was the avoidance of group disapproval: “Subjects expressed fear of conspicuousness, of public exposure of personal defects, and of group disapproval; they felt the loneliness of their situation.” Asch, *Studies on Independence*, *supra* note 221, at 70. The most typical reason for errors given was “the painfulness of standing alone against the majority.” *Id.* Some subjects were “dominated by an imperious desire not to appear different, apparently out of fear of revealing a general and undefined defect.” *Id.* The term “stigma avoidance” has been coined to describe “efforts organization members take to avoid character blemishes associated with exposing wrong doings, or displaying objection to wrongdoings they witness at work.” Patricia Faison Hewlin & Ashleigh Shelby Rosette, *Stigma Avoidance: A Precursor to Workplace Discrimination* 8 (August 2004) (unpublished paper, on file with author) (presented at the Academy of Management Annual Meeting, New Orleans, LA) (discussing stigma avoidance in the context of workplace discrimination as a motivating factor for organizational silence). The definition of “stigma” that I adopt is from sociologist Erving Goffman, who defined “stigma” as an attribute of a person that is deeply discrediting, reducing him or her “in our minds from a whole and usual person to a tainted, discounted one.” See Erving Goffman, *Stigma: Notes on the Management of Spoiled Identity* 3 (1963).

232. Asch, *Studies on Independence*, *supra* note 221, at 31.

233. *Id.* at 37.

234. *Id.* at 32, 47.

235. *Id.* at 32, 46.

236. *Id.* at 46.

"I did not want to be apart from the group; I did not want to look like a fool Scientifically speaking, I was acting improperly, but my feeling of not wanting to contradict the group overcame me."²³⁷

"Here was a group; they had a definite idea; my idea disagreed; this might arouse anger."²³⁸

"When I disagreed I felt outside the group."²³⁹

"I felt disturbed, puzzled, separated, like an outcast from the rest. Every time I disagreed I was beginning to wonder if I wasn't beginning to look funny."²⁴⁰

What significance do Asch's findings have for inside lawyers? If subjects were distressed about following the evidence of their eyes and dissenting from a group of strangers, one can imagine how difficult it may be for a corporate employee to dissent from the position of her colleagues on a complex legal matter.

The Asch experiments suggest that the stigmatization of dissent from a group's opinion is a normal by-product of group identity—however the group is defined. Countless studies have demonstrated that "mere categorization" of people into different nominal groups, even in the absence of any close relationship among group members, can elicit tendencies to associate positive attributes toward in-group members (in-group favoritism) and associate negative attributes toward out-group members (out-group derogation or discrimination).²⁴¹ This tendency is so robust that even the most arbitrary and seemingly inconsequential group classifications can have real behavioral consequences.²⁴²

As the now-abundant literature on whistle-blowers demonstrates, the act of questioning management's actions—or "whistle-blowing"—may cast one as a stigmatized member of the out-group. "Whistle-blowers" are individuals who lack the required authority or power to directly make the change being sought, and therefore must appeal to someone of greater authority, either within the organization (known as internal whistle-blowing) or outside of the organization (known as external whistle-blowing).²⁴³ Although sometimes viewed as reformers, or agents of

237. Asch, *Social Psychology*, *supra* note 221, at 472.

238. Asch, *Studies on Independence*, *supra* note 221, at 46.

239. *Id.* at 48.

240. Asch, *Social Psychology*, *supra* note 221, at 465.

241. See Ross & Nisbett, *supra* note 117, at 40 (describing findings by Henri Tajfel showing that mere categorization of subjects based on artistic preferences for paintings was sufficient to elicit in-group favoritism and out-group derogation).

242. The view that "we" are somehow better and more deserving than "they" is a "rather basic aspect of social perception." *Id.* For a recent and fascinating discussion of Social Identity Theory in the context of race relations, see Jerry Kang, *Trojan Horses of Race*, 118 Harv. L. Rev. 1489, 1533-34 (2005).

243. Janet P. Near & Marcia P. Miceli, *Whistle-Blowers in Organizations: Dissidents or Reformers?*, 9 Res. Org. Behav. 321, 324 (1987).

change,²⁴⁴ whistle-blowers are more commonly viewed as dissidents,²⁴⁵ deviants,²⁴⁶ or traitors.

From the organization's perspective, whistle-blowing represents a voluntary challenge to the "legitimacy of these managers" and concomitantly, a challenge to the authority structure of the organization that serves as the basis for the organization's very existence.²⁴⁷ Moreover, whistle-blowing represents a betrayal of the in-group's "team player" and "anti-finking" norms.²⁴⁸ Thus, the act of whistle-blowing (which is often motivated, in part, by a feeling of company loyalty)²⁴⁹ will often be viewed as the ultimate treachery. All this may help explain why "whistleblowing is an uncommon phenomenon."²⁵⁰

The corporate whistle-blower at Enron, Sherron Watkins, was lauded by Time magazine as one of their 2002 People of the Year,²⁵¹ but the House Subcommittee that so eagerly sought Watkins's testimony took pains to distinguish Watkins from other whistle-blowers: "Ms. Watkins is not a whistle-blower in the conventional sense. She was and is a loyal company employee."²⁵² The implication is clear that most whistle-blowers are not. Idioms that denigrate the status of whistle-blowers abound: He or she is a "party crasher,"²⁵³ a "skunk at a picnic,"²⁵⁴ a "rat fink,"²⁵⁵ a "tattler,"²⁵⁶ a "troublemaker,"²⁵⁷ a "snitch,"²⁵⁸ or a "policeman."²⁵⁹

244. *Id.* at 322; see also Janelle Brinker Dozier & Marcia P. Miceli, *Potential Predictors of Whistle-Blowing: A Prosocial Behavior Perspective*, 10 Acad. Mgmt. Rev. 823 (1985) (arguing that whistle-blowing is a form of prosocial behavior).

245. Near & Miceli, *supra* note 243, at 322.

246. David B. Greenberger, Marcia P. Miceli & Debra J. Cohen, *Oppositionists and Group Norms: The Reciprocal Influence of Whistle-blowers and Co-workers*, 6 J. Bus. Ethics 527, 528 (1987) ("[W]histle-blowing can be one of the most important deviant actions in which an organizational member can engage." (emphasis omitted)).

247. Near & Miceli, *supra* note 243, at 322.

248. We may have a deeply ingrained aversion to "tattling." Social norms against "finking"—reporting wrongdoing behind the wrongdoer's back—have been suggested in several studies on children. For a summary of studies, see Marcia P. Miceli & Janet P. Near, *Blowing the Whistle: The Organizational and Legal Implications for Companies and Employees* 147 (1992) (summarizing studies that showed that subjects were less likely to report when the wrongdoer was of high status); see also Dozier & Miceli, *supra* note 244, at 828 (summarizing Herbert Harari's and John W. McDavid's study of school children evidencing a norm against "finking" on a high social status peer).

249. Miceli & Near, *supra* note 248, at 26 (summarizing the literature and noting that "external whistle-blowers often describe themselves as members who initiated whistle-blowing *because of* their loyalty to the organization" and that "loyal, long-term members may be more likely to blow the whistle than to remain silent").

250. Dozier & Miceli, *supra* note 244, at 834.

251. Richard Lacayo & Amanda Ripley, *Persons of the Year*, Time, Dec. 30, 2002, at 30.

252. *The Financial Collapse of Enron—Part 3: Hearing Before the Subcomm. on Oversight and Investigations of the H. Comm. on Energy and Commerce*, 107th Cong. 3 (2002), available at <http://energycommerce.house.gov/107/action/107-89.pdf> (remarks by Rep. James Greenwood).

253. See, e.g., Jodie Morse & Amanda Bower, *The Party Crasher*, Time, Dec. 30, 2002, at 52.

An inside lawyer who goes over the head of her boss and makes a report under Sarbanes-Oxley to the board of directors may be perceived as not being a “team player.” More likely than not, she will find it easier to stay silent rather than risk the consequences of stigmatization.

b. *Organizational Silence*

The fact that dissent is stigmatized is confirmed by a growing body of organizational behavior literature that explores the causes of employee silence as a collective phenomenon within organizations.²⁶⁰ In one recent exploratory study, Frances Milliken, Elizabeth Morrison, and Patricia Hewlin analyzed the reasons for employee silence, based on interviews with employee subjects.²⁶¹ The study found that being silent about issues and problems at work is a very common experience among employees.²⁶² In addition, a large number of respondents felt that ethical or fairness issues were “undiscussable”—not to be raised with superiors.²⁶³ The major reason reported in the study was the desire to avoid stigma—the fear of

254. See, e.g., Kathleen F. Brickey, *From Enron to WorldCom and Beyond: Life and Crime after Sarbanes-Oxley*, 81 Wash. U. L.Q. 357, 363 n.27 (2003) (noting Senator Charles Grassley’s term).

255. Leonard M. Baynes, *Just Pucker and Blow?: An Analysis of Corporate Whistleblowers, the Duty of Care, the Duty of Loyalty, and the Sarbanes-Oxley Act*, 76 St. John’s L. Rev. 875, 894.

256. See Near & Miceli, *supra* note 243, at 325.

257. See, e.g., Dozier & Miceli, *supra* note 244, at 826.

258. News Release, N.Y. State Bar Ass’n, Vote by American Bar Association to Turn Lawyers into ‘Snitches’ is Not Necessary (Aug. 19, 2003), *available at* <http://www.nysba.org/template.cfm?template=/PressRelease/PressReleaseDisplay.cfm&PressReleaseID=153>.

259. See Panel, *Ethical Dilemmas*, *supra* note 16, at 668-69 (quoting ACC’s general counsel in describing the proposed regulations as transforming the lawyer’s role into that of a policeman).

260. See, e.g., Elizabeth Wolfe Morrison & Frances J. Milliken, *Organizational Silence: A Barrier to Change and Development in a Pluralistic World*, 25 Acad. Mgmt. Rev. 706, 708 (2000) (arguing that widespread organizational silence “is less a product of multiple, unconnected individual choices and more a product of forces within the organization—and forces stemming from management—that systematically reinforce silence”); Craig C. Pinder & Karen P. Harlos, *Employee Silence: Quiescence and Acquiescence as Responses to Perceived Injustice*, in 20 Research in Personnel and Human Resources Management 331 (Gerald R. Ferris ed., 2001) (challenging the predominant assumption that employee silence is “inactive endorsement”).

261. The authors of the study interviewed forty full-time employees working in the consulting, financial services, news media, pharmaceuticals, and advertising industries, who were also part-time MBA students at a large urban university. See Frances J. Milliken et al., *An Exploratory Study of Employee Silence: Issues that Employees Don’t Communicate Upward and Why*, 40 J. Mgmt. Stud. 1453 (2003).

262. *Id.* at 1459 (noting that 85% of the sample said that, on at least one occasion, they felt unable to raise an issue or concern to their bosses even though they felt the issue was important).

263. *Id.* at 1461 (noting that 20% of respondents mentioned that they were unable to raise “ethical or fairness” issues (e.g., professional misconduct, discrimination) and 17.5% were unable to raise “harassment or abuse” issues).

being labeled or viewed negatively as a “troublemaker,” “complainer,” or “tattletale.”²⁶⁴

A second reason for employee silence was the fear that speaking up about issues would damage their relationships with their colleagues—people on whom they relied either for information or to do their job. Employees feared “others (bosses and peers) would no longer like them or view them as credible.”²⁶⁵ In short, they feared the loss of “relational currency” or “social capital.”²⁶⁶

A third reason was “futility: the feeling that speaking up was not worth the effort and would not make a difference.”²⁶⁷

A fourth reason was the fear of retaliation or punishment, such as losing one’s job or not getting a promotion.²⁶⁸ Because Enron was legally advised not to retaliate against Watkins,²⁶⁹ Watkins was not terminated, but was reassigned “from her executive suite to a starkly furnished office 33 floors below and relegated to performing make-work tasks.”²⁷⁰ According to a study of eighty-four whistle-blowers conducted in the early 1990s, “82% experienced harassment after blowing the whistle, 60% were fired, 17% lost their homes, and 10% admitted to attempted suicide.”²⁷¹

Silence is less a product of multiple, unconnected individual choices and more a product of forces within the organization—stemming from management and systematically reinforced by other employees.²⁷² Employees who are silent note that they are not alone in withholding sensitive information. Indeed, many employees in the study suggested that knowledge of a problem was widespread among peers, but not conveyed to senior management.²⁷³ According to the testimony of Sherron Watkins, there was a “culture of intimidation at Enron where there was widespread knowledge of the company’s shaky finances.”²⁷⁴

264. *Id.* at 1463.

265. *Id.*

266. *Id.* at 1470.

267. *Id.* at 1464.

268. *Id.* A fifth reason was the fear “that speaking up might negatively impact someone else in the organization.” *Id.*

269. Within two days of Watkins’s meeting with Enron Chairman Ken Lay, a Vinson & Elkins lawyer had given legal advice to Enron regarding “possible risks associated with discharging (or constructively discharging) employees who report allegations of improper accounting practices,” including a report on the status of Texas law on whistle-blower protection. For a summary, see Brickey, *supra* note 254, at 362.

270. *Id.* at 363 (summarizing Enron’s post-revelatory treatment of Watkins).

271. David Culp, *Whistleblowers: Corporate Anarchists or Heroes? Towards a Judicial Perspective*, 13 Hofstra Lab. & Emp. L.J. 109, 113 (1995).

272. See Morrison & Milliken, *supra* note 260, at 707, 708 (noting that silence is a collective phenomenon, hence their focus on contextual rather than individual-level variables).

273. See Milliken et al., *supra* note 261, at 1465 (noting that seventy-four percent of employees reported that other employees were aware of the issue, but felt uncomfortable speaking up about it).

274. Richard A. Oppel, Jr., *Enron Official Says Many Knew About Shaky Company Finances*, N.Y. Times, Feb. 15, 2002, at A1. Similar reports exist about WorldCom. See

* * *

Even in the face of unethical conduct, conformity pressures that are common to all organizational settings can lead inside lawyers to remain silent and not risk the consequences of whistle-blowing. Although not impossible to resist,²⁷⁵ the desire to avoid stigma and maintain social capital—in essence, to remain a team player—are powerful self-preserving influences. During the debates about Sarbanes-Oxley, the public rhetoric against turning lawyers into prosecutors, policemen, or snitches took on a romper-room-like quality, evidencing a visceral discomfort with the act of whistle-blowing.²⁷⁶ Nobody likes the kid sibling who tattletells on them.

B. *The Cognition*

So far I have argued that inside counsel's situation—of being a mere employee, faithful agent, and team player—makes unethical behavior, at least in the form of acquiescence, likely. But one could object to this story as too deterministic. Why can a smart professional not recognize the situational pressures toward unethical behavior, exercise her moral autonomy, and simply take an ethical stand? Of course, sometimes she can: Witness Watkins's blowing the whistle.

But the conflict is rarely framed in just this stark manner—as a clean choice between venal greed and pure righteousness. The “conflict” is often automatically managed, without our conscious consideration. We, as lawyers, take pride in our ability to process issues in a deliberate, logical manner. Therefore, we tend to underestimate influences on our behavior that are automatic rather than controlled. But cognitive psychology teaches us that many of our mental processes are automatic, rapid, unintentional, effortless, and operate to a great extent without our conscious awareness.²⁷⁷

Yochi J. Dreazen & Deborah Solomon, *WorldCom Aide Conceded Flaws—Controller Said Company Was Forced to Disguise Expenses, Ignore Warnings*, Wall St. J., July 16, 2002, at A3 (reporting that lawmakers released documents in an attempt to bolster their case that WorldCom's accounting irregularities aroused the suspicion of more employees than the company's management had disclosed).

275. See Rod Bond & Peter B. Smith, *Culture and Conformity: A Meta-Analysis of Studies Using Asch's (1952b, 1956) Line Judgment Task*, 119 Psychol. Bull. 111 (1996) (noting that levels of conformity differ among countries and over time).

276. See News Release, N.Y. State Bar Ass'n, *supra* note 258.

277. Nicholas Epley & Eugene M. Caruso, *Egocentric Ethics*, 17 Soc. Just. Res. 171, 173 (2004); see also John A. Bargh, *The Four Horsemen of Automaticity: Awareness, Intention, Efficiency, and Control in Social Cognition*, in 1 Handbook of Social Cognition 1 (Robert S. Wyer, Jr. & Thomas K. Srull eds., 1994) [hereinafter Bargh, *Four Horsemen*]; John A. Bargh et al., *The Automated Will: Nonconscious Activation and Pursuit of Behavioral Goals*, 81 J. Personality & Soc. Psychol. 1014, 1015 (2001) (noting studies that “show that primed information-processing goals produce the same outcomes as goals that have been activated by a conscious act of will”).

The end result of this automatic processing is an objectively acceptable state of affairs.²⁷⁸

1. Self-Serving Bias

A principal way by which this tolerable equilibrium is reached is through what social psychologists call the “self-serving bias.” Self-interest pressures permeate every role taken by inside counsel and are inextricably intertwined with obedience, alignment, and conformity pressures. For example, a “mere employee” will succumb to obedience pressures, not only because she has been socially conditioned to, but also because it is in her obvious self-interest to obey her boss. We all suffer from a tendency to arrive at judgments or estimations that reflect a “self-serving” or “egocentric” bias; we rate attributes that are relevant to our own self-image in a self-serving fashion.²⁷⁹ Although psychologists debate the underlying cause of the self-serving bias, its existence is well-established in the theoretical and empirical literature.²⁸⁰

The self-serving bias is evident in the “above average” effect, whereby well over half of survey respondents typically rate themselves in the top fifty percent of drivers,²⁸¹ ethics,²⁸² managerial prowess,²⁸³ health,²⁸⁴ and productivity.²⁸⁵ A whopping 94% of college professors think they are better than average teachers.²⁸⁶ People also overestimate their own contributions to a collaborative task and, therefore, have a strong tendency

278. See generally David Alain Armor, *The Illusion of Objectivity: A Bias in the Perception of Freedom From Bias* (1998) (unpublished Ph.D. dissertation, University of California Los Angeles) (on file with author).

279. George Loewenstein et al., *Self-Serving Assessments of Fairness and Pretrial Bargaining*, 22 J. Legal Stud. 135, 138 (1993).

280. Linda Babcock & George Loewenstein, *Explaining Bargaining Impasse: The Role of Self-Serving Biases*, 11 J. Econ. Persp. 109, 110 (1997); see also Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)*, 146 U. Pa. L. Rev. 101, 134 (1997) (noting that we should take the egocentric bias seriously as a behavioral risk, even if we cannot determine its exact role in a given context).

281. Ola Svenson, *Are We All Less Risky and More Skillful Than Our Fellow Drivers?*, 47 Acta Psychologica 143 (1981).

282. See generally Raymond Baumhart S.J., *Ethics in Business* 23 (1968) (hard-cover edition published under the title *An Honest Profit*) (reporting that two-thirds of the men rated the practices of their company more ethical than the climate in their industry).

283. See Laurie Larwood & William Whittaker, *Managerial Myopia: Self-Serving Biases in Organizational Planning*, 62 J. Applied Psychol. 194, 198 (1977) (“Studies indicate that self-serving biases are a wide-ranging phenomenon that can affect managerial decision making through the process of overly optimistic planning.”).

284. Ziva Kunda, *The Case for Motivated Reasoning*, 108 Psychol. Bull. 480, 488 (1990) (noting studies which confirm that “[c]ollege students tend to assume that they are and will be healthier than average”).

285. Babcock & Loewenstein, *supra* note 280, at 111.

286. K. Patricia Cross, *Not Can, but Will College Teaching Be Improved?*, 17 New Dir. for Higher Ed.: Renewing and Evaluating Teaching 1, 10 (1977) (finding that ninety-four percent of college professors rate themselves as above average teachers, and sixty-eight percent rank themselves in the top quarter of effective teachers).

to overclaim credit. For example, when Harvard MBA students in study groups were asked to estimate what portion of their group's work each had done, the totals for each study group averaged 139%.²⁸⁷

This self-serving bias is also seen in how we conflate what is fair with what benefits (materially or otherwise) ourselves.²⁸⁸ When study participants were asked to imagine that they had worked different amounts of time at a joint task and assess what a fair compensation would be for themselves and for others who "worked" more or less than they, their judgments were clearly self-serving.²⁸⁹ Participants who "worked" longer hours were more likely to believe that an equal hourly wage was fair. Participants who "worked" shorter hours were more likely to believe that equal pay was fair. This study suggests that self-serving assessments of fairness are likely to occur in morally ambiguous settings where there are multiple possible interpretations about what is fair.²⁹⁰ In addition, "when there are multiple notions of fairness, individuals tend to default to those notions that favor" themselves.²⁹¹ Moreover, it only took a relatively weak adoption of a role (through imagination) to generate a self-serving fairness bias.

The self-serving bias has been confirmed in field studies with actual payoffs,²⁹² in individuals' perceptions of the groups that they are affiliated with,²⁹³ in a simulated labor dispute,²⁹⁴ in real-world public school teacher contract negotiations,²⁹⁵ in practicing physicians recommending treatments

287. Babcock et al., *supra* note 158, at 1337 (noting that "[w]hen married couples estimate the fraction of various household tasks they are responsible for, their estimates typically sum to more than 100 percent"); Banaji et al., *supra* note 12, at 61.

288. Babcock & Loewenstein, *supra* note 280, at 110.

289. David M. Messick & Keith P. Sentis, *Fairness and Preference*, 15 J. Experimental Soc. Psychol. 418, 432, 434 (1979) (finding an egocentric bias in the fairness judgments, observing that "people are capable of ignoring or compromising what they know to be ethically correct in order to achieve a hedonically more preferred outcome").

290. Babcock & Loewenstein, *supra* note 280, at 111.

291. Jason Dana & George Loewenstein, *A Social Science Perspective on Gifts to Physicians from Industry*, 290 JAMA 252, 253 (2003).

292. A doctoral student of Messick's obtained very similar results in a "field study" in which subjects actually worked and were given cash to allocate as they saw fit. See David M. Messick & Keith Sentis, *Fairness, Preference, and Fairness Biases*, in *Equity Theory: Psychological and Sociological Perspectives* 76-79 (David M. Messick & Karen S. Cook eds., 1983) (reporting the unpublished results of experiments performed by Van Avermaet).

293. See Leigh Thompson, "They Saw a Negotiation": *Partisanship and Involvement*, 68 J. Personality & Soc. Psychol. 839, 840 (1995) (describing the classic Hastorf and Cantril 1954 study entitled "They Saw a Game" in which fans of opposing football teams left the game with each group thinking that the referees were partial to the other team).

294. Leigh Thompson & George Loewenstein, *Egocentric Interpretations of Fairness and Interpersonal Conflict*, 51 Organizational Behav. and Hum. Decision Processes 176, 176-97 (1992) (noting that individuals assigned the role of union representatives reported that a higher wage was fairer, whereas those assigned the role of management reported that a lower wage was fairer).

295. See Babcock & Loewenstein, *supra* note 280, at 116-17 (confirming the hypothesis that both sides in public school teacher contract negotiations in Pennsylvania would advance self-serving beliefs about which communities were comparable for purposes of determining teacher salary).

or writing drug prescriptions for the sake of small gifts provided by pharmaceutical companies and equipment suppliers,²⁹⁶ and in practicing lawyers and judges.²⁹⁷ The self-serving bias is all the “more pernicious because people seldom believe it applies to them[]—even when confronted with [persuasive] research.”²⁹⁸

2. Motivated Reasoning

Texas tort case study. The self-serving bias is mediated through the key mechanism of “motivated reasoning,” the process through which we assimilate information in a self-serving manner. In an illuminating study, Linda Babcock, George Loewenstein, Samuel Issacharoff, and Colin Camerer presented subjects with identical materials (depositions, police reports, maps, doctors’ reports) abstracted from an actual Texas lawsuit filed by an injured motorcyclist against the driver of the automobile that collided with him.²⁹⁹ Subjects were randomly assigned to the role of plaintiff or defendant and were told to read the case materials and negotiate a settlement within a certain time. After reading the case materials and before negotiating, subjects were asked to predict the amount the judge would award the plaintiff if negotiations stalled.³⁰⁰

The results confirm the existence of the self-serving bias. Participants playing the motorcyclist plaintiff tended to predict that they would receive significantly larger awards than what the defendants predicted. Armed with the same information, different people reached different conclusions—ones that favored their own interests.

In an experimental variation, a group of subjects were told which role they would play only after having read the case materials and offering their estimates of the judge’s award and a fair settlement.³⁰¹ As predicted by the researchers, those who learned their roles after they read the case materials and offered estimates were significantly more likely to settle and settled at a quicker pace than those who were initially assigned their roles.³⁰² The

296. See Dana & Loewenstein, *supra* note 291, at 254 (discussing research that suggests that even small gifts may be surprisingly influential in creating an unconscious bias in the physician to favor a particular drug treatment, despite self-reports to the contrary).

297. Babcock & Loewenstein, *supra* note 280, at 121 (suggesting self-serving bias as the basis for significant survey results from experienced bankruptcy lawyers and judges on questions relating to lawyers’ fees in bankruptcy cases); Theodore Eisenberg, *Differing Perceptions of Attorney Fees in Bankruptcy Cases*, 72 Wash. U. L.Q. 979 (1994).

298. Max H. Bazerman & George Loewenstein, *Taking the Bias Out of Bean Counting*, Harv. Bus. Rev., Nov. 2001, at 28. For research showing the prevalence of the “bias in the perception of freedom from bias,” see Armor, *supra* note 278.

299. This study is reported in detail in Babcock et al., *supra* note 158, at 1337-42.

300. *Id.* at 1338-39; Babcock & Loewenstein, *supra* note 280, at 112.

301. Babcock et al., *supra* note 158, at 1339; Babcock & Loewenstein, *supra* note 280, at 113.

302. Ninety-four percent of the pairs who did not know their roles initially settled and settled in an average of 2.51 periods, but only 72% of those who knew their roles initially settled and settled in an average of 2.51 periods. In other words, when subjects did not know their roles initially, only 6% of the negotiations had to be resolved by a judge. However,

results indicate a strong tendency toward self-serving judgments of fairness and predictions of the judge's award when subjects knew of their roles prior to reading the written materials.³⁰³ Similar results were obtained when, after the negotiation, subjects were presented with sixteen arguments favoring either the plaintiff or defendant and were asked to predict how a neutral third party would rate each of those arguments.³⁰⁴

The results of this study confirm the findings of prior research on the connection between self-serving biases and selective information processing or "motivated reasoning." Because we are imperfect information processors, we first automatically determine our "preference for a certain outcome on the basis of self-interest and then justify this preference on the basis of fairness by changing the importance of attributes affecting what is fair."³⁰⁵ When a situational cue such as a role (for example, plaintiff or defendant) is conferred upon a subject, a "directional goal," the goal of arriving at a desired conclusion,³⁰⁶ is triggered. With a directional goal, people are "more likely to search spontaneously for hypothesis-consistent evidence than for inconsistent evidence."³⁰⁷ Directional goals can bias reasoning, but this influence is limited by cognitive factors, such as available beliefs and rules of logic, which will determine the magnitude of bias.³⁰⁸

The Texas tort case study demonstrates that complex and ambiguous contexts (such as a tort case) where multiple arguments can be generated are ideal environments for triggering self-serving biases, because they allow subjects to focus on, or weight, differentially, arguments favoring themselves (or their clients or de facto principals) over other parties.³⁰⁹ Accordingly, the complex nature of law, whether you are dealing with federal securities law to determine if there is a duty to disclose to the

when subjects knew their roles initially, 28% had to be resolved by the judge. Babcock et al., *supra* note 158, at 1339-40.

303. Furthermore, the magnitude of the bias was a significant predictor of bargaining impasse. *Id.* at 1341.

304. *Id.* at 1339-40; Babcock & Loewenstein, *supra* note 280, at 114-15.

305. Max H. Bazerman et al., *The Impossibility of Auditor Independence*, 38 Sloan Mgmt. Rev. 89, 91 (1997).

306. See Kunda, *supra* note 65, at 212.

307. Kunda, *supra* note 284, at 495; see also Peter H. Ditto & David F. Lopez, *Motivated Skepticism: Use of Differential Decision Criteria for Preferred and Nonpreferred Conclusions*, 63 J. Personality & Soc. Psychol. 568, 569 (1992) (noting the "robust tendency of individuals to perceive information that is consistent with a preferred judgment conclusion (preference-consistent information) as more valid than information that is inconsistent with that conclusion (preference-inconsistent information)"); *id.* at 570 (noting that studies support the conclusion that "information consistent with a preferred judgment conclusion is less likely to initiate intensive cognitive analysis than is information inconsistent with that conclusion").

308. Kunda, *supra* note 284, at 495.

309. Babcock et al., *supra* note 158, at 1342; Babcock & Loewenstein, *supra* note 280, at 122.

public³¹⁰ or professional rules to determine what to do when a co-agent is breaking the law,³¹¹ makes it a fertile breeding ground for the kind of motivated and self-serving interpretations that rationalize unethical actions.

As suggested above, through motivated reasoning, ethical dilemmas can be managed in a manner that avoids stark conflict. Understanding how the mind processes information makes clear how this is possible. It is now widely accepted in social and cognitive psychology that two processing systems are often at work when a person makes judgments or solves problems.³¹² These two systems can operate simultaneously, “in parallel[,] and are capable of reaching differing conclusions.”³¹³ The first system invokes automatic processes. It is a more intuitive system of processes that are relatively rapid, effortless, automatic, involuntary, and—to a large extent—operate without our conscious awareness. The second system invokes controlled processes. It is a more reflective system of processes that are relatively deliberate, voluntary, controlled, analytical, and effortful, as well as rules-based. Self-interest tends to exert a more automatic influence than, say, any moral reasoning that goes into determining one’s ethical responsibilities, which would tend to be invoked through controlled processing.³¹⁴

Given the dual nature, we tend to have superior introspective access to our controlled processes than our automatic processes; that is, “we can often articulate the various costs and benefits that went into a deliberate decision,”³¹⁵ but we are generally unable to recall the automatic cognitive processes that pulled us toward certain actions.³¹⁶ Because of this limited access to our automatic processes, their influence on judgment and decision making is difficult to eliminate or correct. The consequence of this

310. Even more so than bean counting, ambiguity characterizes most legal issues relating to the duty to disclose under Rule 10b-5. See Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 Vand. L. Rev. 1639 (2004).

311. See *ABA Preliminary Report*, *supra* note 142 (criticizing the 2002 text of Model Rule 1.13); Burton & Dzienkowski, *supra* note 7, at 718 (criticizing Rule 1.13 from the perspective of in-house counsel as providing “withdrawal” as the last available option); Roger C. Cramton, *Enron and the Corporate Lawyer: A Primer on Legal and Ethical Issues*, 58 Bus. Law. 143, 174-75, 180 (2002) (criticizing Model Rule 1.13(b) for being unhelpful and ambiguous).

312. Jonathan Haidt, *The Emotional Dog and its Rational Tail: A Social Intuitionist Approach to Moral Judgment*, 108 Psychol. Rev. 814, 819 (2001) (citing Bargh, Chartrand, Greenwald, and Banaji).

313. *Id.* at 819; see also Thomas Gilovich & Dale Griffin, *Introduction to Heuristics and Biases: The Psychology of Intuitive Judgment* 16 (Thomas Gilovich et al. eds., 2002) (arguing that the parallel-processing model provides a better explanation of the “dual process” nature of cognition, because it does “not postulate two different ‘routes’ of information processing that operate in either-or fashion according to the motivation of the information processor”).

314. Don A. Moore & George Loewenstein, *Self-Interest, Automaticity, and the Psychology of Conflict of Interest*, 17 Soc. Just. Res. 189, 190 (2004).

315. *Id.* at 192.

316. See Haidt, *supra* note 312, at 822 (comparing post hoc moral reasonings with a priori moral theories).

differential processing is that automatic processes tend to dominate—they tend to be “first on the scene,” with controlled processes acting mainly as a potential, but severely constrained, override.³¹⁷

As Jonathan Haidt has noted, “The emerging view in social cognition is that most of our behaviors and judgments are . . . made automatically.”³¹⁸ Haidt has persuasively argued that, while people tend to believe that their moral judgments are backed by logic, most moral judgments in fact result from quick, automatic evaluations, akin to aesthetic judgments, with explicit moral reasoning playing a largely secondary role.³¹⁹ Therefore, instead of our moral reasoning causing our moral judgment (as we would like to believe), moral reasoning is more likely to be the rational tail that wags the emotional dog, a post-hoc construction³²⁰ intended to justify automatic—and typically self-interested—judgments. When asked to explain previous behaviors, we engage in an effortful search that may feel like introspection.³²¹ In fact, we are actually searching for a priori causal theories—“a pool of [plausible,] culturally supplied explanations for behavior.”³²² Here, for example: “My duty as a zealous advocate required me to keep confidences no matter what the harmful consequences may be.” To be clear, this is not to say that moral reasoning plays no ex ante causal role in ethical decision making.³²³ Since we are highly attuned to group norms, we are less likely to engage in conduct that clearly violates those norms. Explicit moral reasoning may play a role in societies or professions in defining those norms and prescribing what is minimally acceptable conduct.

The venality hypothesis supposes a unimodal model of cognition, in which the wayward individual makes an explicit and calculated decision to sacrifice ethics for self-interest. The banality hypothesis, however, supposes a more complex, bimodal view of cognition, in which the

317. The overriding ability of controlled processes is severely constrained by our lack of introspective access to automatic processes and the controlled system’s “serial processing” nature and reactivity to cognitive load. Moore & Loewenstein, *supra* note 314, at 193. It is important not to overstate the dichotomy. Most complex mental processes studied by social psychologists are not exclusively automatic or exclusively controlled but are in fact combinations of both. See Bargh, *Four Horsemen*, *supra* note 277, at 3.

318. Haidt, *supra* note 312, at 819 (citing Bargh, Chartrand, Greenwald, and Banaji) (emphasis omitted).

319. See *id.* at 823.

320. See *id.*

321. As Haidt has argued, we are not really searching for a memory of the actual cognitive processes that caused behaviors, because these processes are generally not accessible (operate outside of our conscious awareness). *Id.* at 822.

322. *Id.* (citing a 1977 study conducted by Nisbett & Wilson). As argued by Haidt, a priori moral theories provide acceptable reasons for praise and blame—e.g., “unprovoked harm is bad,” or “people should strive to live up to God’s commandments.” *Id.*

323. See *id.* at 828-29 (reconciling and integrating rationalism and intuitionism). But see Wegner, *supra* note 37, at 26, 97 (arguing that our intuitive belief that we consciously will our voluntary actions is illusory, and that the experience of control or conscious will is not a direct indication of their real causal influence on action, but rather a misapprehension of the mechanistic causal relations underlying our own behavior).

individual is not always fully aware of the extent to which her decisions are in fact driven by the automatic pursuit of self-interest and—in cases where the unethical route is taken—any moral reasoning concerning fiduciary duties to the organizational client fails to override self-interest.³²⁴

Other heuristics or tendencies. Alloyed with the self-serving bias are other heuristics or tendencies that make bad decisions seem, well, not so bad—especially in the context of securities fraud. We are more likely to hurt and ignore victims who are statistical or abstract—actual and potential shareholders of a large publicly held corporation, for example—rather than individuals whom we personally know.³²⁵ We also tend to be far more responsive to immediate consequences (for example, a forthcoming bonus or raise) than delayed ones, especially if delayed outcomes are uncertain (for example, legal sanctions for securities fraud).³²⁶ We also tend to view sins of omission (for example, not disclosing a material company development) as more acceptable than sins of commission (for example, affirmative misrepresentations).³²⁷ And, as Milgram's experiments show, we also tend to engage in ethical lapses where harm is immaterial and then escalate our commitment to previously chosen courses of actions to avoid

324. With respect to inside counsel, however, it is not only self-interest that exerts the powerful automatic influence on ethical decisions. Inside counsel are also affected by obedience, alignment, or conformity pressures.

325. See Moore & Loewenstein, *supra* note 314, at 197; Deborah A. Small & George Loewenstein, *Helping a Victim or Helping the Victim: Altruism and Identifiability*, 26 J. Risk & Uncertainty 5 (2003). In all public securities fraud cases, the victims are actual or potential shareholders, a large and diffuse group, largely unknown to management or counsel, whereas management are viewed as paying "clients" (or, in the case of inside counsel, bosses) with whom they have an ongoing relationship. Bazerman et al., *supra* note 305, at 92 (noting that auditors are likely to be well acquainted with people who would be hurt by a negative audit).

326. David M. Messick & Max H. Bazerman, *Ethical Leadership and the Psychology of Decision Making*, 37 Sloan Mgmt. Rev. 9, 11 (1996); Moore & Loewenstein, *supra* note 314, at 198. For inside counsel, complicity with management's unethical behavior might mean a larger bonus, better perquisites, or closer bonding, whereas refusal to follow unethical orders might mean confrontation, humiliation, and the loss of a job. This is not to say that we should give up on legal sanctions; they are important, but they should not be our sole method. The prospect of punishment represents yet another situational feature that influences the behavior of potential transgressors, and "the harsher and more certain those prospects, assuming that the potential aggressor in question is rational, the greater the general deterrent value." Ross & Shestowsky, *supra* note 70, at 1103; see also Robert A. Prentice, *The Case of the Irrational Auditor: A Behavioral Insight into Securities Fraud Litigation*, 95 Nw. U. L. Rev. 133, 176-79 (2000) (noting the "time-delay trap").

327. Messick & Bazerman, *supra* note 326, at 15; Ann E. Tenbrunsel & David M. Messick, *Ethical Fading: The Role of Self-Deception in Unethical Behavior*, 17 Soc. Just. Res. 223, 230 (2004). This "omission bias" is particularly relevant for lawyers in securities fraud contexts, who choose not to prevent or report a co-agent's wrongdoing. When fraud proceeds, even though the lawyer had a clear opportunity to stop it, it is easy to shift any blame from self to others, especially when the lawyer can point to the wrongdoer's specific actions as the "proximate cause" for the harm, or the board as the ultimate decision maker.

admitting (to ourselves and others) that those actions were improper, or to cover up our previous mistakes.³²⁸

* * *

In sum, the “moral autonomy” objection carries some, but not decisive, force. To think that it wins the contest is part of the venality hypothesis mindset, to think that inside counsel generally knows the difference between right and wrong and makes a conscious choice to commit sin for personal gain. Sometimes this is true. But the banality hypothesis suggests that the typical story is different. When complexity or ambiguity presents itself, it is interpreted in ways to avoid the stark moral choice that the “moral autonomy” objection forces. In many situations, we automatically dodge that hard choice by becoming blind to its very existence. Given the situation, inside counsel are inclined to acquiesce, and the moral choice that seems so obvious in hindsight or from an academic perch afar is never even experienced as a fully conscious decision.

III. RECENT REFORM: MISUNDERSTANDING THE ETHICAL ECOLOGY

In Part III, I critique section 307 of Sarbanes-Oxley and the ABA’s 2003 amendments to the Model Rules as ignoring the situation of inside counsel by not addressing the ethical ecology of inside counsel, thus, setting them up for failure under the new, congressionally mandated gatekeeper regime. To be clear, my task is not to defend or justify the particular model of gatekeeping chosen by Congress, implemented by the SEC, and grappled with by the ABA. Rather, it is to show why the particular solutions adopted by the SEC and the ABA ultimately fail to address the situational pressures of inside counsel and are thus inadequate. This Article is prescriptive in nature: It analyzes the incongruity between the expressed goals of Sarbanes-Oxley (deputizing inside counsel as gatekeepers) and the specific solutions advanced by the SEC and the ABA.

A. Background

1. Sarbanes-Oxley Section 307

In response to the major corporate scandals of this new century, Congress enacted Sarbanes-Oxley, which became effective on July 30, 2002,³²⁹ to

328. “Milgram’s own analysis” of his experiments pointed out “the gradual, stepwise character of the shift from” mild feedback to lethal harm. Ross & Nisbett, *supra* note 117, at 56. This method avoids a single, explicit confrontation of moral values and incrementally and carefully shapes the subject into obedience as the stepwise progression continues and the shocks reach alarming levels. See Miller, *supra* note 53, at 33 (noting Steven Gilbert’s analysis of the graded shock process); Ross & Nisbett, *supra* note 117, at 56.

329. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (to be codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

restore integrity to the U.S. capital markets by promoting corporate responsibility, accountability, and transparency.³³⁰ Sarbanes-Oxley imposed harsh penalties for violators, created an elaborate system for governing and regulating auditors, and required the securities industry's self-regulatory organizations to adopt prophylactic rules that prevent conflicts of interest and enhance the independence of securities analysts.³³¹

With respect to lawyers, it delegated authority to the SEC to establish "minimum standards of professional conduct" under section 307. This represents the first time in history³³² that the SEC would have sweeping authority to establish rules that would enable it to discipline lawyers "appearing or practicing before the Commission." The genesis of section 307 was a simple request to the SEC by forty legal academics, led by Professor Richard Painter in March 2002, to require lawyers to report unrectified securities law violations to the board.³³³ The SEC declined to act,³³⁴ and the proposal was then submitted to Congress.

Senators John Edwards, Michael Enzi, and Jon Corzine introduced the proposal during the floor debate³³⁵ as a late amendment to the Sarbanes

330. See, e.g., 148 Cong. Rec. H5462 (daily ed. July 25, 2002) (statement of Rep. Oxley).

331. Roger C. Cramton et al., *Legal and Ethical Duties of Lawyers After Sarbanes-Oxley*, 49 Vill. L. Rev. 725, 728 (2004) (describing the purpose of Sarbanes-Oxley).

332. Current Rule 102(e) of the SEC's Rules of Practice permits the SEC to initiate disciplinary proceedings against attorneys who violate the securities laws, assist in someone else's violation, or otherwise engage in unprofessional conduct. The predecessor to Rule 102(e), Rule 2(e), was promulgated by the SEC on its own initiative in 1935. This rule, however, has only rarely been the basis of lawyer discipline, and the SEC ordinarily will not initiate proceedings under this rule unless a prior criminal conviction or civil injunction for a securities law violation has been obtained. See Royce De R. Barondes, *Professionalism Consequences of Law Firm Investments in Clients: An Empirical Assessment*, 39 Am. Bus. L.J. 379, 407 (2002).

333. Letter from Richard W. Painter et al., to Harvey Pitt, Chairman, U.S. Sec. & Exch. Comm'n (Mar. 7, 2002), available at <http://www.fed-soc.org/Publications/practicegroupnewsletters/PG%20Links/pittletter.htm>. Painter has long advocated clarification of a lawyer's duties with respect to corporate fraud. See Richard W. Painter, *Rule Lawyers Play By*, 76 N.Y.U. L. Rev. 665, 719 (2001); Richard W. Painter, *Toward a Market for Lawyer Disclosure Services: In Search of Optimal Whistleblowing Rules*, 63 Geo. Wash. L. Rev. 221 (1995) (proposing a voluntary, contractual regime of lawyer whistle-blowing, whereby lawyers could select and publicize the rules by which they will be governed, enforceable by third party civil liability and disciplinary sanctions); Richard W. Painter & Jennifer E. Duggan, *Lawyer Disclosure of Corporate Fraud: Establishing a Firm Foundation*, 50 SMU L. Rev. 225 (1996) (proposing SEC Rules, or alternatively, an amendment to the Exchange Act, requiring up-the-ladder reporting by issuer's counsel, either to the issuer's full board or to a committee of issuer's board designated by the issuer in advance).

334. Letter from David Becker, Gen. Counsel, Sec. & Exch. Comm'n, to Richard W. Painter et al. (Mar. 28, 2002), available at <http://www.abanet.org/buslaw/corporateresponsibility/becker.pdf> (responding to an earlier letter of Painter et al. and declining to consider the matter because of the legal profession's heated opposition to it and the SEC's lack of express legislative authority).

335. 148 Cong. Rec. S6551 (daily ed. July 10, 2002) (testimony of Sens. John Edwards and Richard Durbin).

bill.³³⁶ With the assistance of Professor Susan Koniak, the Senators defended the so-called “Edwards Amendment” against opposition fueled by the ABA.³³⁷ The cosponsors agreed that the spotlight of corporate responsibility should shift to lawyers, since many constituents believed that the recent scandals could not have occurred but for the fact that the lawyers failed in their gatekeeper duties. Senator Edwards stated,

The truth is that executives and accountants do not work alone. Anybody who works in corporate America knows that wherever you see corporate executives and accountants working, lawyers are virtually always there looking over their shoulder. If executives and/or accountants are breaking the law, you can be sure that part of the problem is that the lawyers who are there and involved are not doing their jobs.

. . . .

. . . With Enron and WorldCom, and all the other corporate misconduct we have seen, it is again clear that corporate lawyers should not be left to regulate themselves no more than accountants should be left to regulate themselves.³³⁸

The Edwards Amendment provided that when lawyers, in the course of representing a client, encounter evidence of a material violation of law relevant to the SEC’s jurisdiction, they must report the existence of such evidence up the corporate ladder—to the board of directors, if necessary—and ensure that the evidence is investigated and any wrongdoing rectified. The amendment to the Sarbanes bill passed the Senate by a vote of 97-0.³³⁹

On January 23, 2003, the SEC issued part 205, the final regulations called for under section 307 of Sarbanes-Oxley.³⁴⁰ These rules reflect the SEC’s expectation that general counsels, as CLOs of public companies, will be primarily responsible for investigating and advising the board and senior management on how to address reports of material violations. Accordingly, senior SEC officials have urged general counsels to play a more active role in policing compliance with Sarbanes-Oxley through the development of a more assertive relationship with the board and management. Alan Beller,

336. The bill (S.2673) was sponsored by Senate Banking Committee chairman Paul Sarbanes and passed the Senate by a vote of 97-0 on July 15, 2002. 148 Cong. Rec. S6734, 6778-79 (daily ed. July 15, 2002).

337. See Cramton, *supra* note 311, at 175-76, 179 n.147 (noting the contributions from Professor Susan Koniak and opposition from the ABA). The ABA lobbied Congress against passage of section 307, arguing that the federal government should stay out of lawyer regulation because state bar authorities would enact appropriate reforms to address the problem of lawyers in the recent frauds. See Susan P. Koniak, *Corporate Fraud: See, Lawyers*, 26 Harv. J.L. & Pub. Pol’y 195, 220-21 (2003).

338. 148 Cong. Rec. S6551, 6551-52 (daily ed. July 10, 2002).

339. See Koniak, *supra* note 337, at 220.

340. See Standards of Professional Conduct for Attorneys, 17 C.F.R. § 205 (2003). These regulations became effective on August 5, 2003. These rules cover any SEC-reporting company, including companies that have filed (and not withdrawn) a 1933 Securities Act registration statement with the SEC.

Director of the Division of Corporation Finance of the SEC, urged general counsels to claim “[a] place at the table at every significant discussion about how [her] company should act with respect to every important issue raised by Sarbanes-Oxley, [SEC] rules or other aspects of the new environment.”³⁴¹ Beller also emphasized that general counsels should seek “[a]ccess to the board . . . to assure good behavior.”³⁴² According to Beller, regardless of whether she is a securities law specialist or not involved “in detail in financial reporting decisions,” the general counsel is “the chief legal officer, and thus has the responsibility for getting the legal requirements right.”³⁴³

These comments assume that general counsels’ passivity or acquiescence in managerial misconduct derive from a lack of assertiveness—a dispositional quality. This is an example of the fundamental attribution error. In the SEC’s view, general counsels could play a greater role in their companies if only they would, by an act of conscious will, assert themselves more, claim a place “at the table,” and, magically, gain “access to the board.” The sad reality is that many inside counsel (including general counsels) do not have independent access to the board and are constrained by their formal or informal job descriptions.³⁴⁴ The SEC officials’ faith in people’s ability to simply will themselves into a position of greater access (and thus power) demonstrates an unexamined reliance on the venality hypothesis.

But, as I have detailed above, the ethical ecology is much more complex than an issue of disposition (assertiveness) or an act of conscious will. Inside counsel are subject to situational pressures—arising out of their multiple roles as mere employees, faithful agents, and team-players—that induce them to acquiesce in managerial fraud, and Sarbanes-Oxley does nothing to mitigate those pressures. Before I critique part 205 in detail, I briefly summarize the regulations.

Up-the-ladder reporting. The basic reporting rule is this: An attorney must report any “evidence of a material violation”³⁴⁵ to the CLO, or to both the CLO and CEO, subject to a futility exception.³⁴⁶ Unless the attorney

341. Allan L. Beller, Dir., Div. of Corp. Fin., Remarks before the ABA’s 2003 Conference for Corporate Counsel (June 12, 2003) (transcript available at <http://www.sec.gov/news/speech/spch061203alb.htm>).

342. *Id.*

343. *Id.*

344. A recent survey of inside counsel reported that at least forty-four percent of inside counsel believed that better access to the board was needed to ensure the well-being of their corporate clients. See Brown, *supra* note 148, at 96-97.

345. “Evidence of a material violation” means “credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur.” 17 C.F.R. § 205.2(e). “Material violation” means a material violation of U.S. federal or state securities law, a material breach of fiduciary duty arising under any federal or state law, or a similar material violation of any federal or state law. *Id.* § 205.2(i).

346. *Id.* § 205.3(b)(4). This basic reporting rule is subject to what is known as “the futility exception”: The attorney may directly report to the board or a committee thereof if

reasonably believes that the CLO or CEO has provided an “appropriate response”³⁴⁷ within a reasonable time, he must go over their heads and report further to the board or an appropriate board committee.³⁴⁸ If the attorney has taken the report “up the ladder” and does not reasonably believe that the company has made an appropriate response, the attorney must explain the reasons for this belief to the CLO, CEO, and directors to whom the report was made.³⁴⁹

Alternative reporting rule. An alternative reporting mechanism may be used if the company has previously formed a Qualified Legal Compliance Committee (“QLCC”), a committee of independent board members³⁵⁰ charged with adopting written procedures for confidentially receiving, retaining, and considering any report of evidence of a material violation, and with recommending remedial measures.³⁵¹ Under this alternative rule, the attorney or the supervisory attorney may bypass the CEO or CLO and submit a report directly to the QLCC (if the company has previously formed a QLCC) and need not determine further whether the company has made an appropriate response. The QLCC will determine whether an investigation is necessary and may incur any expense (including retaining experts) in order to perform an investigation. The QLCC may notify the SEC if recommended remedial measures are not implemented.³⁵²

CLO’s obligations. When the CLO receives a report of evidence of a material violation, she is responsible for piloting its investigation, taking

she reasonably believes it would be futile to report to the Chief Legal Officer (“CLO”) or CEO.

347. “Appropriate response” means a response as a result of which the reporting attorney reasonably believes that (1) no material violation has occurred, is ongoing, or is about to occur; or (2) the issuer has adopted appropriate remedial measures, including appropriate steps or sanctions to stop an ongoing material violation, to prevent a future violation, or to remedy (or otherwise appropriately address) a past violation and minimize the possibility of its recurrence; or (3) the issuer, with the consent of the board of directors or an appropriate committee thereof, has retained or directed an attorney to review the evidence of material violation and has either substantially implemented such attorney’s remedial recommendations (after a reasonable investigation and evaluation of the reported evidence) or has been advised that such attorney may assert a colorable defense on behalf of the issuer (or its officers or agents) in any investigation or judicial or administrative proceeding. *Id.* § 205.2(b).

348. He must report to (a) the audit committee of the issuer’s board; or (b) if the issuer does not have an audit committee, another board committee consisting entirely of nonemployee directors; or (c) if the issuer does not have any such committee, the board of directors. *Id.* § 205.3(b)(3).

349. *Id.* § 205.3(b)(9).

350. *Id.* § 205.3(c). The Qualified Legal Compliance Committee (“QLCC”) may be the issuer’s audit committee (which under new SEC rules must consist exclusively of independent directors) or a separate board committee consisting of at least three members—one member of the audit committee and two or more nonemployee directors. *Id.* § 205.2(k).

351. It should be noted that, while the QLCC must have the authority and responsibility to recommend that an issuer implement an “appropriate response,” the final rules do not require that the QLCC have the authority to direct such action itself, except that the QLCC has the authority to notify the SEC if the issuer fails to implement an appropriate response that the QLCC has recommended. *Id.*

352. *Id.*

any necessary remedial measures, and providing an “appropriate response” to the reporting attorney. If the company has previously formed a QLCC, the CLO can refer the matter directly to the QLCC (without making any further inquiry) and advise the reporting attorney of such referral.³⁵³

Permissive “reporting out.” An attorney may, but is not required to, reveal to the SEC, without the company’s consent, confidential information relating to his representation. The triggering standard for “reporting out” is considerably more stringent than the triggering standard for the initial “reporting up.”³⁵⁴

2. 2003 Amendments to the Model Rules

Although attorney professional conduct is governed by the rules promulgated and enforced by the highest court in the state where the attorney practices, most state ethics codes are based on the Model Rules,³⁵⁵ which have “symbolic importance and salience to practicing lawyers that may even exceed that of formally applicable ethics rules of individual states.”³⁵⁶ Moreover, the Model Rules are carefully studied in most law schools’ professional responsibility courses, where nascent role ideologies begin to form. Given the above, it makes sense to focus on the Model Rules amendments as a tool for understanding how the leaders of the legal profession diagnose and attempt to resolve the problem of lawyer acquiescence in fraud.

In response to the scandals, the ABA created its Presidential Task Force on Corporate Responsibility (“ABA Task Force”) in March 2002 to address “systemic issues relating to corporate responsibility arising out of the unexpected and traumatic bankruptcy of Enron and Enron-like situations”³⁵⁷ The ABA Task Force identified two rules to be reviewed: Model Rule 1.6 on the duty of confidentiality and Model Rule 1.13, the rule on representing organizations.³⁵⁸

353. *Id.* § 205.3(b)(2).

354. *See id.* § 205.3(d)(2). In contrast to the triggering standard for “reporting up,” where an attorney is obligated to report credible evidence when it would be unreasonable for her not to conclude that a material violation is reasonably likely to occur (or have occurred, or is ongoing), the triggering standard for “reporting out” is triggered when there is a clear sense of urgency. An attorney may “report out” if she reasonably believes reporting out is necessary to (a) prevent the company from committing a material violation that is likely to cause substantial injury to the financial interest or property of the issuer or investors; or (b) rectify the consequences of a material violation that caused (or may cause) such injury, if the attorney’s services were used in furtherance of the violation; or (c) prevent the company from committing or suborning perjury, or perpetrating a fraud upon the SEC. *Id.*

355. *See ABA Preliminary Report, supra* note 142, at 202 n.22.

356. Lawrence A. Hamermesh, *The ABA Task Force on Corporate Responsibility and the 2003 Changes to the Model Rules of Professional Conduct*, 17 *Geo. J. Legal Ethics* 35, 56 (2003).

357. *See ABA Preliminary Report, supra* note 142, at 189 (quoting Mission Statement of ABA Task Force).

358. Hamermesh, *supra* note 356, at 36-37.

On August 11 and 12, 2003, after a “highly visible battle,”³⁵⁹ the ABA House of Delegates adopted amendments to Model Rules 1.6 and 1.13, which were substantially the same as those recommended in the ABA Task Force’s final report. Rule 1.6 was changed to allow disclosure of client fraud in well-defined situations involving grave future or ongoing harm.³⁶⁰ Rule 1.13 was amended to (i) require the lawyer, under certain circumstances, to inform the highest authority of an organization when responsible co-agents fail to take action to address a law violation and (ii) permit her, under certain circumstances, to disclose confidential information outside the organization when the highest authority of the organization fails to address a law violation.³⁶¹

In short, the basic problem with the Model Rules amendments is that they appear to have served the function of “a backstop addressing extraordinary and deviant circumstances.”³⁶² This reflects a common view that lawyer acquiescence in misconduct is not a widespread problem and that only “a few bad apples” are responsible. Also, the language of the amendments suggests that the drafters were preoccupied with the unlikely scenario that lawyers would engage in unwarranted, rampant whistle-blowing.³⁶³ This shows a profound misunderstanding of the ethical ecology of inside and outside lawyers, who are more inclined to find any excuse to avoid reporting co-agent misconduct.

To be clear, I do not argue that the ABA shared Sarbanes-Oxley’s goals of imposing gatekeeping duties on lawyers. Although the ABA attempted to conform to the core SEC up-the-ladder reporting rule, some have described those efforts as primarily motivated by the conservative desire to derail any further federal regulation.³⁶⁴

359. *Id.* at 56.

360. Pre-2003 Model Rule 1.6 had imposed a strict duty of confidentiality, permitting the lawyer to disclose client confidences only if necessary to prevent a criminal act likely to result in imminent death or substantial bodily harm, and under other narrow circumstances. Although the ABA Model Rules have been widely adopted by states, most states had not adopted the pre-2003 Model Rule 1.6. *See ABA Preliminary Report*, *supra* note 142, at 206 (noting that “[f]orty-one states either permit or require disclosure to prevent a client from perpetrating a fraud that constitutes a crime, and eighteen states permit or require disclosure to rectify substantial loss resulting from client crime or fraud in which the client used the lawyer’s services”).

361. Model Rules of Professional Conduct R. 1.13(b), (c) (2004).

362. Hamermesh, *supra* note 356, at 36, 55 (noting that “even amended Model Rule 1.13(b) will apply only in relatively extreme cases”).

363. As an example of unfounded fears of rampant whistle-blowing, see, e.g., Lawrence J. Fox, *The Academics Have It Wrong: Hysteria Is No Substitute for Sound Public Policy Analysis*, in *Enron: Corporate Fiascos and Their Implications*, *supra* note 7, at 851, 869 (expressing the fear of “too many up-the-ladder reports” to the board).

364. *See* Cramton et al., *supra* note 331, at 729-33 (describing the ABA’s efforts relating to Sarbanes-Oxley); Koniak, *supra* note 337, at 220-21.

B. Critique

1. Mere Employee

Sarbanes-Oxley fails to adequately address the obedience pressures that arise from inside counsel's status as "mere employees." It does little to overcome an employee's natural reluctance to go over the heads of superiors to make an unwelcomed report. In addition, it fails to address the formidable self-interest pressures that arise from the employee status by not providing inside counsel with protection against retaliation for making a good-faith report or immunity against disciplinary sanctions for reasonable disclosures of co-agent's confidences in a nonfrivolous claim for retaliatory discharge.

Sarbanes-Oxley relies predominantly on the ill-advised "chain-of-command" approach for reporting misconduct.³⁶⁵ According to the SEC implementing regulations, a "subordinate" attorney must report evidence of a material violation to her "supervisory" attorney unless she "reasonably believes" that her supervisory attorney has failed to comply with the regulations.³⁶⁶ In the unlikely scenario that she will make that determination, she can then report to the CLO, who has special responsibilities to investigate the allegations. The "chain-of-command" approach generally does not facilitate internal whistle-blowing, especially when "top managers are implicated."³⁶⁷ When an inside lawyer must utilize existing chains of command to forward a report, obedience and self-interest pressures will generally sway her against reporting. Moreover, a significant number of securities frauds are committed by senior managers, often CEOs.³⁶⁸

One could counter that the SEC provided a viable option to the "chain-of-command" approach with its alternative QLCC reporting rule. Under this rule, the attorney or the supervisory attorney may freely bypass the CEO or CLO and submit a report directly to a preformed QLCC. She is then relieved from having to make any further determination about whether

365. 17 C.F.R. § 205.3(b) (2003) states that, if an attorney becomes aware of evidence of a material violation, she must report such evidence to the CLO, or to both the CLO and CEO, subject to a "futility" exception.

366. *Id.* § 205.5(c), (d). For a critique of Sarbanes-Oxley's treatment of subordinate in-house counsel, see Lisa H. Nicholson, *Sarbox 307's Impact on Subordinate In-House Counsel: Between a Rock and a Hard Place*, 2004 Mich. St. L. Rev. 559.

367. Elletta Sangrey Callahan et al., *Integrating Trends in Whistleblowing and Corporate Governance: Promoting Organizational Effectiveness, Societal Responsibility, and Employee Empowerment*, 40 Am. Bus. L.J. 177, 205 (2002).

368. Arlen & Carney, *supra* note 138, at 727 (concluding, based on the evidence, that agents sued for fraud are more often senior managers, as opposed to lower-level employees); Elizabeth MacDonald & Joann S. Lublin, *SEC May Put Small Firms in Audit Plan: Proposals for Strengthening Corporate Audit Panels Influenced by New Data*, Wall St. J., Mar. 25, 1999, at A2 (reporting that a study of more than 200 corporate fraud cases brought by the SEC in recent years found that, in eighty-three percent of the cases, the CEO or CFO, or both, were involved in the fraud).

the company has appropriately responded.³⁶⁹ This approach can provide an attractive safe harbor for attorneys, because the QLCC, as the anointed recipient of all reports, will obviate the need for the attorney to make the difficult case-by-case determination of whether to circumvent her superiors.³⁷⁰ Creation of this independent and centralized channel for submitting reports will mitigate obedience pressures, because utilizing such a channel is less likely to be seen as “insubordinate” or “disruptive” to the sacred reporting relationships. The main problem with this QLCC alternative is that the QLCC is not mandatory, and few companies feel compelled to create one in the absence of a mandatory “reporting out” provision (where an attorney would be required to report unrectified misconduct to the SEC under certain circumstances), which, under the previous SEC proposals, the QLCC approach would have obviated the need for.³⁷¹ In addition, even if the company has previously formed a QLCC under the regulations, a subordinate attorney still may not report directly to the QLCC unless she reasonably believes that her supervisory attorney (to whom she has submitted a report) has failed to comply with the regulations.³⁷²

Sarbanes-Oxley also does little to relieve the self-interest pressures that inevitably arise from the employee status. If the inside attorney makes an unwelcomed report to the board, her boss could demote her, give her a smaller bonus, freeze her salary, or worse, terminate her, upon which she would lose all of her unvested stock options, insurance, or other benefits. Moreover, she could be professionally blacklisted and, in many states, left with no legal recourse to sue for retaliatory discharge.³⁷³

The SEC implementing regulations do not afford inside lawyers much, if any, assurance from retaliation. While, under the final rules, the inside lawyer may notify the board (or any committee thereof) of any retaliatory

369. 17 C.F.R. § 205.3(c).

370. While, arguably, providing this “safe harbor” allows the inside lawyer to, once again, punt the ultimate responsibility, on balance it should encourage inside counsel to report misconduct to the board in the first place.

371. A company’s adoption of a QLCC would have eliminated any “reporting out” obligations of both inside or outside attorneys under either of the two mandatory “reporting out” proposals which the SEC had originally proposed (neither of which was finally adopted). Under either proposal, inside and outside attorneys can satisfy their reporting obligations by referring the matter to a QLCC and need not further assess whether the company undertook appropriate remedial measures. Any authority or responsibility to report outside of the company would rest solely in the hands of the QLCC. See Sabino Rodriguez III & Robert Knuts, Esq., *Representing the Public Company: A Post-Sarbanes-Oxley Governance Paradigm for In-House Lawyers and Outside Counsel*, 8 Briefly: Persp. on Legis., Reg., & Litig. 1, 45-46 (2004) (noting that many issuers shunned QLCCs in the initial months following the effective date of the final rules, because the QLCC would remove control over the process from the CLO, and companies perceived this as “potentially disruptive”).

372. 17 C.F.R. § 205.5 (d).

373. For a discussion of inside counsel’s right to sue under a retaliatory discharge claim in whistle-blower protection, see *infra* Part IV.B.

act,³⁷⁴ the SEC rules do not guarantee her any protection from any adverse personnel action, including retaliatory discharge.³⁷⁵ The final rules conspicuously fail to mention whether the inside attorney has any legal rights of redress or whether she may even notify the SEC of the mere fact of her termination. Inexplicably, while the SEC's originally proposed "reporting out" provision permitted both employed or retained attorneys to report their retaliatory discharge to the SEC,³⁷⁶ the final rules do not address retaliation at all.³⁷⁷ This silence exacerbates self-interest pressures. A permissive "reporting out" provision that at least allowed attorneys to report retaliatory acts to the SEC would have reassured attorneys that they would not be disciplined for reporting retaliation. Additionally, this provision would have strengthened the attorney's hand when making the initial report up the ladder, encouraging boards to address the alleged law violation in good faith. Under the regulations, while the attorney has the option to "report out" to the SEC a company's unaddressed material law violation, she does not have the consistent option to "report out" her retaliatory discharge.

Although the SEC is silent about retaliatory discharge, Sarbanes-Oxley contains two federal whistle-blower protection provisions that may be construed to apply to inside lawyers. The civil whistle-blower protection provision, section 806, prohibits retaliatory action against employees who engage in both internal or external whistle-blowing, but it is limited in its applicability to publicly traded companies and to specified federal subject matters (for example, securities fraud).³⁷⁸ The criminal provision, section 1107, makes it a felony for a publicly traded or privately held employer to take any retaliatory action against an employee who engages in external whistle-blowing about evidence of any federal crime, whether they voluntarily come forth or are sought out by investigators.³⁷⁹ While the

374. 17 C.F.R. § 205.3(b)(10). The SEC states in the adopting release that "[t]his provision, an important corollary to the up-the-ladder reporting requirement, is designed to ensure that a [CLO] . . . is not permitted to block a report to the issuer's board or other committee by discharging a reporting attorney." See Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8185, 79 SEC Docket 1351 (Jan. 29, 2003), *available at* 2003 WL 193527, at *27 [hereinafter Adopting Release].

375. This may be due to the fact that the SEC may not feel it has the authority under the statute to create whistle-blower protection for inside attorneys.

376. Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8150, 67 Fed. Reg. 71,670 (proposed Nov. 21, 2002) (proposed § 205.3(d)(4)). The proposing release did not specify what remedies, if any, the SEC could have sought in such circumstances.

377. The second "reporting out" proposal is also silent with respect to whether employed or retained attorneys may report their retaliatory discharge to the SEC, although the proposal requires them to notify the issuer's CLO. Implementation of Standards of Professional Conduct for Attorneys, Securities Act Release No. 33-8186, 68 Fed. Reg. 6324 (proposed Jan. 29, 2003) (proposed § 205.3(d)(3)).

378. 18 U.S.C.A. § 1514A(a) (West Supp. 2003).

379. *Id.* § 1513(e); *see also* Brickey, *supra* note 254, at 367-68 (noting that this provision is limited to apply to retaliatory conduct that occurs in connection with providing information to federal authorities).

plain language of sections 806 and 1107 suggest that whistle-blower protection should cover inside attorneys, the lack of clear legislative intent and clear language extending protection to inside lawyers is problematic in light of conflicting state court decisions on whether inside counsel even have the right to sue for retaliatory discharge.³⁸⁰

Moreover, even assuming that the inside attorney has the right to sue under state or federal statute or common law, can she disclose co-agents' confidences to pursue a claim of retaliatory discharge? Unfortunately, the state of the law here is also conflicting and, at least with respect to federal whistle-blower protection, fails to protect inside lawyers.³⁸¹ Although the plain language of the relevant SEC regulation permitting disclosure of issuers' confidences is fairly broad³⁸² and could be interpreted to permit disclosure of co-agents' confidences to establish a claim of retaliatory discharge against a former employer, it is not at all clear whether the SEC would endorse such an interpretation. The adopting release emphasizes the defensive and protective nature of this disclosure rule, suggesting that this rule may not be relied upon in an offensive legal action launched by the attorney.³⁸³

2. Faithful Agent

Sarbanes-Oxley and the Model Rules amendments fail to adequately address the alignment pressures that arise from inside counsel's status as "faithful agents." They fail to mitigate (and, in some respects, affirmatively contribute to) the automatic tendency to conflate the organizational client with senior management. The SEC accomplishes this by relying solely on behavioral exhortation, and the ABA does the same by failing to develop a coherent analysis of an agent's authority under Rule 1.13 and by maintaining the misguided structure of Rule 1.6, which fails to distinguish between organizational and individual clients.

As described in Part II, the situational pressures that arise from the special agency relationship between the inside lawyer and the corporate officer as de facto principal can sway the inside lawyer to conform her

380. See *infra* Part IV.B (discussing whistle-blower protection).

381. See *infra* Part IV.B (discussing *Willy v. Coastal Corp.*).

382. 17 C.F.R. § 205.3(d)(1) (2003) states, "Any report under this section (or the contemporaneous record thereof) or any response thereto (or the contemporaneous record thereof) may be used by an attorney in connection with any investigation, proceeding, or litigation in which the attorney's compliance with this part is in issue."

383. In its accompanying release, the SEC stated,

Paragraph (d)(1) makes clear that an attorney may use any records the attorney may have made in the course of fulfilling his or her reporting obligations under this part to defend himself or herself against charges of misconduct. It is effectively equivalent to the ABA's present Model Rule 1.6(b)(3) and corresponding "self-defense" exceptions to client-confidentiality rules in every state. The Commission believes that it is important to make clear in the rule that attorneys can use any records they may have prepared in complying with the rule to protect themselves. Adopting Release, *supra* note 374, at 1735.

conduct to the officer's preferences. These alignment pressures affect both inside and outside lawyers in ways that can induce acquiescence in corporate misconduct. These alignment pressures arise because the actual principal of the lawyer, the organizational client, is fictitious and can only act through its agents, to whom inside lawyers are accountable.

The SEC regulations open with a reminder that an attorney owes "his or her professional and ethical duties to the issuer as an organization," and that the "issuer's officers, directors, or employees" that the attorney advises in the course of representing the company are not the attorney's clients.³⁸⁴ While the SEC correctly spotted the issue of conflation, its response consists mainly of behavioral exhortation.

The Model Rules contribute to these alignment pressures. Rule 1.13 adheres to what is known as the "entity theory of representation," the view that the organizational entity, and not its individual constituents (officers, employees, board, shareholders), is the client of the lawyer: A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.³⁸⁵

According to this view, the lawyer can safely accept direction from her co-agents, who have been entrusted with a position of authority to speak on behalf of the client and to direct the lawyer's services.³⁸⁶ Therefore, "authority" of the co-agent is the touchstone.³⁸⁷

Rule 1.13(b) sets forth the ABA's model "reporting up" provision. According to this amended rule, if a lawyer for an organization knows that a co-agent violates a duty to the organization or otherwise engages in a law violation "that reasonably might be imputed to the organization," the lawyer "shall proceed as is reasonably necessary in the best interest of the organization"—but only if the misconduct in question is "likely to result in substantial injury to the organization."³⁸⁸ The lawyer is then instructed to "refer the matter to higher authority in the organization," "[u]nless the lawyer reasonably believes that it is not necessary in the best interest of the corporation to do so."

Conspicuously, this rule fails to develop a coherent analysis of a co-agent's authority, saying nothing about whether such authority expires upon an unlawful act or a violation of his fiduciary duty to the principal, although it is well established that an agent, no matter how high up in the corporate hierarchy, "cannot lawfully overstep the limits imposed by the principles of

384. 17 C.F.R. § 205.3(a). For a discussion on how the SEC refrained from imposing a fiduciary duty on shareholders, see Stephen Fraidin & Laura B. Mutterperl, *Advice for Lawyers: Navigating the New Realm of Federal Regulation of Legal Ethics*, 72 U. Cin. L. Rev. 609, 628-29 (2003).

385. Model Rules of Prof'l Conduct R. 1.13(a) (2004).

386. Geoffrey C. Hazard, Jr. & W. William Hodes, *The Law of Lawyering* § 1.13:106, at 395 (2001).

387. William H. Simon, *Whom (Or What) Does the Organization's Lawyer Represent?: An Anatomy of Intraclient Conflict*, 91 Cal. L. Rev. 57, 80 (2003) (criticizing the incoherence of Model Rule 1.13).

388. Model Rules of Prof'l Conduct R. 1.13(b).

agency law on an agent's authority to commit to a course of action on behalf of the principal."³⁸⁹ This omission gives the dangerous impression that the co-agent still maintains some degree of authority to direct the actions of the lawyer, even if he has violated his fiduciary duties to the corporation. As noted by William Simon, "Even the highest authority, when it engages in an injurious and 'clearly' illegal course of conduct, is not 'duly authorized.' If it lacks authority to engage in the conduct, then it lacks authority to instruct the lawyer to remain passive about it."³⁹⁰ The failure of the rule to make this very simple pronouncement reinforces the Model Rules' general tendency to conflate the organizational client with management.³⁹¹ This certainly contributes to substantial alignment pressures arising out of the fact that lawyers are generally accountable to management.

We see the same tendency to conflate the organizational client with management in Rule 1.6, the rule on confidentiality. Rule 1.6 prohibits the disclosure of "information relating to the representation,"³⁹² except in narrowly limited circumstances. On top of the original exceptions,³⁹³ amended Rule 1.6(b) permits (but does not mandate) a lawyer to reveal confidential information to the extent the lawyer reasonably believes necessary (1) "to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another . . .,"³⁹⁴ and (2) "to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is

389. Hazard, *supra* note 87, at 1014. Perhaps the failure to include an analysis of the co-agent's authority reflects the ABA's reluctance to give the attorney the discretion to determine valid "authority." But if the attorney does not make this determination, who will? Whatever the ABA's reason, this is not surprising, as suggested by Robert Nelson, given the historical opposition within the organized bar to any obligations on corporate practitioners to go over the head of wrongdoing management. Nelson, *supra* note 166, at 542.

390. See Simon, *supra* note 387, at 81.

391. *Id.* at 65 ("[C]ourts treat the principle of corporate representation as conclusive against the constituent's claim by tacitly conflating the interests of the corporation with those of incumbent management.").

392. As the commentary to Rule 1.6 suggests, "information relating to the representation" is extremely broad. Model Rules of Prof'l Conduct R. 1.6 cmt. 1. It applies not only to matters communicated in confidence by the client, but also to all information relating to the representation, "whatever its source." *Id.* R. 1.6 cmt. 3. Presumably, this category is significantly broader than what the attorney work product doctrine or the attorney-client privilege would protect from disclosure.

393. Prior to its amendment, Model Rule 1.6(b) permitted the lawyer to reveal confidential information "to prevent reasonably certain death or substantial bodily harm," "to secure legal advice about the lawyer's compliance with [the Model Rules]," "to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client," and "to comply with other law or a court order." *Id.* R. 1.6(b). The original "substantial bodily harm" exception was so restrictive that, absent clear evidence of criminal intent, the corporate lawyer was well advised to presume that Model Rule 1.6(b)(1), as originally enacted, would not be triggered. 1 John K. Villa, Corporate Counsel Guidelines § 3.11, at 3-82 (2005).

394. Model Rules of Prof'l Conduct R. 1.6(b)(2).

reasonably certain to result or has resulted from the client's commission of a crime or fraud"³⁹⁵

These precepts apply only if, in either case, the client uses or has used the lawyer's services to further the crime or fraud.³⁹⁶ The ABA ultimately opted for permissive disclosure, although many in the ABA Task Force believed that "mandatory disclosure of client crime would strengthen the lawyer's hand in persuading a client to abandon conduct known by the lawyer to be criminal, and would do so more effectively than mere permission to disclose."³⁹⁷

The addition of the two new exceptions to the overarching duty of confidentiality are symbolically significant, because they represent a retreat from the organized bar's rigid stance that no further exception to this duty is necessary. However, these changes do not represent a significant change to the actual rule in most jurisdictions.³⁹⁸ Moreover, there are endemic problems with this rule that these crafted exceptions simply do not cure. First, the framing of the rule improperly suggests that the lawyer still owes a duty to a wrongdoing co-agent. This rule was drafted against the paradigm of the individual client, rather than the organizational client,³⁹⁹ although the vast majority of legal representations involve organizational clients and most managerial fraud (certainly, the most serious kind) happens in the corporate context. Thus, by not distinguishing the individual client from a co-agent of the client, the rule conflates the organizational client with management. While this conflation may be grounded in the felt need for a uniform rule, the effect is to give the impression that the lawyer still owes a general duty of confidentiality to the co-agent, even when that co-agent exceeds his agency authority (unless the co-agent's conduct triggers one of the narrow exceptions to the rule).

Second, the framing of the rule predetermines that any exceptions to the rule will be exceedingly narrow. By not distinguishing wrongdoing co-agents from individual clients, the rule deems any disclosures made by the

395. *Id.* R. 1.6(b)(3).

396. *Id.* R. 1.6(b)(2), (b)(3); *see also* Hamermesh, *supra* note 356, at 40 (describing the rationale behind the "lawyer's services" limitation as resting on the belief that the client's use of the lawyer's services to perpetrate crime or fraud "constitutes an abuse by the client of the client-lawyer relationship, forfeiting the client's absolute entitlement to the protection of Model Rule 1.6").

397. Hamermesh, *supra* note 356, at 38. Certainly, there is a significant difference in tone between the statement, "If you violate the law, I have no choice but to report," (which is likely to be interpreted as an honest attempt to follow professional mandates) and "If you violate the law, I may report you" (which sounds much more like a "power play").

398. "Forty-one states either permit or require disclosure to prevent a client from perpetrating a fraud that constitutes a crime, and eighteen states permit or require disclosure to rectify substantial loss resulting from client crime or fraud in which the client used the lawyer's services." *ABA Preliminary Report*, *supra* note 142, at 206. Most states refused to adopt the ABA's 1983 version of Model Rule 1.6. *See* Hamermesh, *supra* note 356, at 49.

399. George C. Harris, *Taking the Entity Theory Seriously: Lawyer Liability for Failure to Prevent Harm to Organizational Clients Through Disclosure of Constituent Wrongdoing*, 11 *Geo. J. Legal Ethics* 597, 612 (1998).

lawyer to be “adverse” to the client, an interpretation that the comments to the rule openly endorse.⁴⁰⁰ “Adverse disclosures” are generally justifiable on the very rare occasion when the lawyer’s duty to the public or to third parties outweighs the lawyer’s duty of confidentiality and loyalty to her wrongdoing client.⁴⁰¹

But in the corporate context, disclosures of confidences entrusted by a co-agent can actually be “‘loyal’ disclosures,” which are justifiable not despite loyalty to the client, but because of loyalty to the client.⁴⁰² For loyal disclosures, there is no need to balance the interest of the organizational client against the interest of the potential victim, because the client is the victim of the intended crime or fraud.⁴⁰³ Only benefit to the organizational client is needed. Although Rule 1.6(b) was amended to address the issue of managerial fraud in the corporate context, it misses the boat. Actually, any loyal disclosures that benefit the organizational client would have been consistent with even the primary confidentiality rule, which permits disclosures that are “impliedly authorized in order to carry out the representation”⁴⁰⁴ By not even entertaining the possibility of “loyal disclosures” in the corporate context, the Model Rules contribute to alignment pressures and the tendency to conflate senior management with the corporate client.

Third, the crafted exceptions are so narrow that only egregious misconduct, assisted by legal advice, is contemplated, limiting the impact of the amendments. In order for an exception to be triggered, the crime or fraud must “reasonably [be] certain” to result in “substantial” injury to the “financial interests or property of another,” and the client must have used the lawyer’s services “in furtherance of” such crime or fraud. But what if the crime or fraud is false revenue recognition that could still amount to billions of dollars worth of financial statement misrepresentation? Under the current articulation of the rule, a lawyer may be constrained in disclosing a co-agent’s confidences to stop such a massive fraud (to the extent not waived by the corporation) because her services may not be deemed to have been “in furtherance of” such fraud.⁴⁰⁵

3. Motivated Reasoning

While Sarbanes-Oxley and the Model Rules amendments also fail to address the conformity pressures that arise from inside counsel’s status as a

400. The comments to the rule are entitled “Disclosure Adverse to Client” and frame the issue as one in which the “public interest” (as opposed to the interest of the organizational client) is served.

401. *See* Harris, *supra* note 399, at 599.

402. *Id.*

403. *Id.* at 602.

404. Model Rules of Prof’l Conduct R. 1.6(a) (2004).

405. Securities lawyers are not necessarily involved in the drafting of financial statements or the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” portion of the registration statement.

“team player” of the company, as discussed in greater detail below,⁴⁰⁶ such pressures are extremely difficult to mitigate and, thus, I do not expect the SEC or the ABA to have addressed them in a systematic manner. Rather, I focus my critique now on motivated reasoning.

In Part II, I described the situational pressures under the umbrella of the various roles of inside lawyers—as mere employees, faithful agents, and team players. But self-interest pressures permeate all these roles and exert a general, automatic influence on all ethical decision making. Motivated reasoning is the key mechanism by which ethical issues are obscured and stark conflict is avoided.

The Texas tort case study described in Part II above showed that complex and ambiguous contexts can serve as a fertile breeding ground⁴⁰⁷ for motivated reasoning, which leads to self-serving interpretations of the situation that will rationalize the lawyer’s passivity. Complexity arises when a problem has numerous initial options or those options cascade into a “decision tree” with still more options. Ambiguity arises when decision makers are constrained in their knowledge of certain facts necessary to make the optimal decision, or when decision makers are uncertain about how certain facts or rules (perhaps due to the indeterminate nature of those rules and facts) will affect the ultimate outcome.⁴⁰⁸ There are many examples of such “fertile breeding grounds” in Sarbanes-Oxley and the Model Rules. I will note just a few.

Pursuant to the SEC regulations under Sarbanes-Oxley, an attorney’s reporting obligation is triggered when she becomes aware of “evidence of material violation,” defined as “credible evidence, based upon which it would be unreasonable, under the circumstances, for a prudent and competent attorney not to conclude that it is reasonably likely that a material violation has occurred, is ongoing, or is about to occur.”⁴⁰⁹

This complex standard adopted by the SEC contains a double negative, which violates the SEC’s own “plain English” rules and is difficult to understand, interpret, and apply.⁴¹⁰ It will be even more difficult to enforce, requiring the SEC’s staff to assume the impossible burden of proving two negatives.⁴¹¹ Also, “materiality” is intentionally left undefined by the rules.⁴¹² Since “material” modifies the term “violation,” which itself

406. See *infra* Part IV.D (Ethical Norms).

407. See *supra* Part II.B.2 (discussing the Texas tort case study).

408. For an excellent discussion on judgments under complexity and ambiguity, see Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 Cal. L. Rev. 1051, 1077-84 (2000).

409. 17 C.F.R. § 205.2(e) (2003).

410. Rule 421(d) under the Securities Act of 1933 states, “You must draft the language . . . so that at a minimum it substantially complies with each of the following plain English writing principles: . . . (vi) No multiple negatives.” *Id.* § 230.421.

411. See Cramton et al., *supra* note 331, at 752-53.

412. The adopting release states that the term should be read as understood under the U.S. federal securities laws, citing leading cases which have established a fact is material if there is “a substantial likelihood that the . . . fact would have been viewed by the reasonable

is extremely broad,⁴¹³ presumably more than the violation's financial impact should be considered.

The SEC's qualification that the evidence must show that a material violation is "reasonably likely" is also unduly confusing. The adopting release states that, "[t]o be 'reasonably likely' a material violation must be more than a mere possibility, but it need not be 'more likely than not.'"⁴¹⁴ SEC staff members have unofficially stated publicly that "reasonably likely" means less than "'more probably than not' and that conduct in the 'the 20%-40% range of likelihood' should trigger a report."⁴¹⁵ Unfortunately, most attorneys would probably understand the phrase to mean "probably or more likely than not."⁴¹⁶ The muddled language will surely create a breeding ground for bias.

We see similar complexity and ambiguity in the Model Rules amendments, which reflect a distinct reluctance to adopt the gatekeeping regime finally settled on by the SEC. Before a lawyer may resort to reporting up the ladder, Model Rule 1.13(b) requires that the lawyer know that the decision in question violates a duty to the organization or otherwise engages in a law violation "that reasonably might be imputed to the organization" and is "likely to result in substantial injury to the organization."⁴¹⁷ The Model Rules define the term "knows" as meaning "actual knowledge of the fact in question."⁴¹⁸ Thus, this triggering standard is subjective and imposes a very high level of certainty, which will be nearly impossible to meet in decisions involving, for example, a co-agent's breach of the duty of due care.⁴¹⁹ The adoption of the subjective standard also reinforces the principle that the lawyer is not generally charged with the duty to investigate the accuracy of a client's recitation of the relevant facts.⁴²⁰

investor as having significantly altered the 'total mix' of information made available." See Adopting Release, *supra* note 374, at 1728 n.59 (citing *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976)); Fraidin & Mutterperl, *supra* note 384, at 632 (noting possible interpretation of the SEC's definition of "materiality").

413. Violations of any federal or state law, including breaches of fiduciary duty arising out of federal or state law, are contemplated. See 17 C.F.R. § 205.2(i).

414. Adopting Release, *supra* note 374, at 1727.

415. Cramton et al., *supra* note 331, at 754 (citing Simon N. Lorne, *An Issue-Annotated Version of the SOX 307 Rules*, in Attorneys' Liab. Assurance Soc'y, Loss Prevention Programs A-117, A-125 (June 12, 2003)).

416. *Id.* at 755 (citing Comments of Attorneys' Liability Assurance Society, Inc., on the SEC Proposed Rule 205 (Mar. 28, 2003), <http://www.sec.gov/rules/proposed/s74502/attorneyslia1.htm>).

417. While "substantial injury" is not expressly defined, the ABA Task Force described the relevant circumstances as "[an] extraordinary circumstance of a significant failure of governance that puts or threatens to put the interest of the organization into serious jeopardy." Am. Bar Ass'n, Report of the American Bar Association Task Force on Corporate Liability 45 (2003) [hereinafter ABA Final Report].

418. Model Rules of Prof'l Conduct R. 1.0(f) (2004).

419. Villa, *supra* note 393, § 3.07[C].

420. *Id.* § 3.20[D][2] (noting that, nonetheless, the lawyer is not privileged to turn a blind eye to information that appears dubious).

Model Rule 1.13(b) is replete with qualifications that give the lawyer more room to talk herself out of reporting up.⁴²¹ When the duty to report up is finally triggered, the lawyer “shall proceed as is reasonably necessary in the best interest of the organization.”⁴²² And what is “in the best interest of the organization”? The rule does not explicitly define the vague term, but the comment to the rule suggests that, ordinarily, up-the-ladder reporting to a “higher authority” would be necessary,⁴²³ “[u]nless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so”⁴²⁴ Also, if “warranted by the circumstances,” the lawyer may refer the matter to the “highest authority that can act on behalf of the organization as determined by applicable law.”⁴²⁵ Although up-the-ladder reporting of violations is literally mandatory (as evident by use of the term “shall”), this is quite misleading, given the replete qualifications, the highly subjective triggering standard, and the wide discretion not to act if acting is deemed to be not “in the best interest of the organization.”

What is the “highest authority”? The comment to the rule states that the organization’s highest authority would ordinarily be the board of directors, noting that “applicable law may prescribe that under certain conditions the highest authority reposes elsewhere, for example, in the independent directors of a corporation.”⁴²⁶ Curiously, the comment does not mention shareholders as potentially the “highest authority,” although under state corporations codes, shareholders alone are entitled to decide on certain fundamental matters.⁴²⁷ Of course, with publicly held corporations, “informing shareholders would . . . be tantamount to public disclosure.”⁴²⁸ Although there are reasons why this should be cautiously undertaken,⁴²⁹

421. She can always argue, for example, that a co-agent’s conduct cannot “reasonably” be imputed to the organization, that it is not “likely” to result in “substantial” injury, that reporting up or out is “not necessarily in the best interest of the organization,” that the circumstances do not “warrant” referring the matter to the “highest authority,” or that “reporting out” is not “necessary” to prevent “substantial” injury to the organization. The list goes on and on.

422. Model Rules of Prof’l Conduct R. 1.13(b).

423. *See id.* R. 1.13, cmt. 4 (“Ordinarily, referral to a higher authority would be necessary.”).

424. *Id.* R. 1.13(b).

425. *Id.*

426. *See id.* R. 1.13 cmt. 5 (2003).

427. Simon, *supra* note 387, at 82. For example, certain rights, such as preemptive rights, can only be modified through an amendment of the organization’s charter document. Amendments to charter documents typically require a shareholder vote.

428. *Id.*

429. As discussed by William Simon, public disclosure could affect the stock price and trigger shareholder lawsuits and government investigations, but if these potential consequences were to be viewed merely as “default decision-making procedure[s] when the normal corporate processes fail to achieve agreement” and as an “extension of the corporate processes,” public disclosures could be entirely consistent with acting in the best interests of the organization. Of course, an assessment of whether going forward with litigation is truly in the best interests of the corporation would require some evaluation of the substantive merits. *See id.* at 84.

going to shareholders may be the most appropriate course of action, as the court in *SEC v. National Student Marketing Corp.* decided.⁴³⁰

If the misconduct by co-agents is so serious that the organization is imminently threatened with “substantial injury,”⁴³¹ and remedial measures are either ineffective or nonexistent, the organization’s lawyer has little further recourse. At this point, Rule 1.13(c) gives the lawyer one final option: a very restricted right to go outside the organization for help when she concludes that the highest echelons of the organization were acting against its interests.⁴³² This “reporting out” provision is permissive, not mandatory: The lawyer “may” reveal confidences entrusted by the co-agent, “but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.”⁴³³ “Reporting out” may be done without regard to any restrictions under the duty of confidentiality provision of Rule 1.6. Therefore, according to the comment, it is not necessary that the lawyer’s services be used in furtherance of the violation (as required for disclosure under Rule 1.6), although it is required that the matter still be “related to the lawyer’s representation of the organization.”⁴³⁴

As noted above in the previous section, the framing and qualified language of Rule 1.6 make it an unlikely basis for a lawyer’s decision to “report out” to protect the organizational client. A lawyer wishing to “report out” would more likely rely on the more expansive “reporting out” provision of Rule 1.13, provided that she is not unduly confused by Rule 1.6’s incongruity with Rule 1.13. Although amended Rule 1.13 was intended to “more actively encourage” up-the-ladder reporting,⁴³⁵ both Rules 1.6 and 1.13 seem to discourage the lawyer from doing so in the first place.

In sum, Sarbanes-Oxley and the Model Rules amendments provide the type of complex and ambiguous environment (a “fertile breeding ground”) where self-serving interpretations of the situation that lead to lawyer acquiescence are likely to take root. The confusing or high triggering standards, the copious qualifications, and the cautionary language, as well as the lack of any coherent theory of a co-agent’s authority, make it difficult for any lawyer to be confident in her decisions to report up the ladder or report out, if she chooses to do so.

430. 457 F. Supp. 682, 713 (D.D.C. 1978) (holding that the lawyers violated the antifraud norms of the securities laws by proceeding with closing, instead of insisting that shareholder proxies be resolicited with disclosure of the new information).

431. Model Rules of Professional Conduct Rule 1.13(c) states that the lawyer may make further disclosures outside of the organization if “the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization” and remedial measures are ineffective.

432. Hazard & Hodes, *supra* note 386, § 1.13:401, at 421.

433. Model Rules of Prof’l Conduct R. 1.13.

434. *See id.* R. 1.13 cmt. 6.

435. *See* ABA Final Report, *supra* note 417, at 44.

* * *

With respect to inside counsel, the recent reform's impact will be limited because, ultimately, it is based on an inadequate model of fraud, the venality hypothesis, which cognitively misorients us away from the lion's share of the problem. This model's assumption is that accommodating lawyers are explicitly and deliberately choosing the unethical route; thus, recent reform relies predominantly on behavioral exhortation, backed by the threat of disciplinary or civil sanctions,⁴³⁶ as the solution.⁴³⁷ But the solution to the problem of lawyer acquiescence in fraud cannot arise from merely recalibrating a "rational" actor's cost-benefit calculus. The solution needs to address the complex economic, psychological, and ideological forces that incline inside counsel to be complicit in fraud, not through any overt or explicit calculation, but through a subtle and implicit reconfiguration of preferences, self-conception, and motivation.

IV. ALTERNATIVE REFORM: TRANSFORMING THE ETHICAL ECOLOGY

In this part, alternative reforms are proposed which transform the ethical ecology of inside counsel for the purpose of supporting the new gatekeeping responsibilities imposed by the SEC. Organized from most important to least important, it is generally proposed that (i) public companies transfer the oversight of the corporate legal department to a committee of independent board members; (ii) the law guarantee whistleblower protection to inside counsel under Sarbanes-Oxley and, accordingly, permit the disclosure of client confidences under any claim alleging retaliation under Sarbanes-Oxley or a common law claim of retaliatory discharge; and (iii) public companies limit ex ante the amount of equity investments that an inside lawyer may accept as compensation or, in the alternative, fashion equity compensation in a manner that minimizes potential conflicts of interest.

These general measures are based on the premise that "[f]or the gatekeeper to be an effective monitor of management on behalf of investors, it must be independent of management."⁴³⁸ Accordingly, these measures should enhance the independence of inside counsel by neutralizing or redirecting the situational pressures that lead to acquiescence in managerial misconduct. They should encourage inside counsel to (i) prevent

436. 17 C.F.R. § 205.6 (2004) ("Sanctions and discipline"). A violation of section 205 shall subject the attorney to "civil penalties and remedies for a violation of the federal securities laws" and the "disciplinary authority of the [SEC]." *Id.*

437. To be fair, Lawrence Hamermesh, the Reporter to the ABA Task Force, has admitted that the 2003 amendments, standing alone, are "ineffectual and incomplete," and that these amendments were submitted as a mere supplement to other corporate compliance initiatives. Hamermesh, *supra* note 356, at 54, 55. Also, the Task Force did make a few "mild" corporate governance recommendations, which are beyond the scope of this Article. See *ABA Preliminary Report*, *supra* note 142, at 197-201 (proposed corporate governance recommendations).

438. See Coffee, *Gatekeeper Failure*, *supra* note 11, at 335.

misconduct by reducing the benefits of unpunished acquiescence in managerial wrongdoing and (ii) police misconduct by encouraging inside counsel to monitor, investigate, and report the misconduct of culpable co-agents.⁴³⁹ Below, I spell out in greater detail the content of my proposals as well as how they mitigate or reduce the situational pressures discussed in Part II.

A. Structure

In response to the prosecution's query as to why Belnick failed to raise with board members the issues flagged by outside counsel,⁴⁴⁰ Belnick's defense attorneys argued that this chief counsel, despite his high stature, simply lacked independent access to the board. First, in Belnick's view, reporting his concerns to the board was not his job. He had not regularly read the minutes of the board's compensation or audit committees. "It was not my obligation to keep an eye on the committees," he said to the prosecutor. "You act as if I was there as a prosecutor."⁴⁴¹

Second, even when Belnick sought out board access, he was rebuffed by Kozlowski. When the board convened to discuss the \$20 million unauthorized finders' fee to board member Frank Walsh, Kozlowski beckoned Belnick, who was invited to the meeting, to meet him at the doorway—and then firmly pushed him out of the door.⁴⁴²

Third, Belnick was repeatedly reminded of his status as subordinate and outsider. Kozlowski regularly belittled and undermined Belnick's authority. He persisted in mispronouncing his name as "Bel-a-nick."⁴⁴³ He hired a law firm behind Belnick's back.⁴⁴⁴ Belnick was being "second-guessed on the company's response to possible government regulatory questions about faulty sprinkler heads."⁴⁴⁵ An inside attorney that Belnick had fired was rehired the next day by Kozlowski into a Tyco division.⁴⁴⁶

439. For an overview of "preventative" and "policing" measures, see Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. Rev. 687, 693 (1997) (analyzing the diverse mechanisms through which corporate liability can influence legal compliance).

440. Belnick failed to raise with the Board concerns about management's use of loan programs for personal purposes and certain aggressive acquisition accounting practices. These concerns were initially raised by Tyco's outside counsel, Wilmer, Cutler & Pickering. See Lin, *supra* note 28.

441. Anthony Lin, *Combative Cross Examination of Belnick Continues*, N.Y. L.J., June 29, 2004, at 4.

442. Belnick attempted to hire Sullivan & Cromwell to probe the unapproved and undisclosed mid-2001 \$20 million finder's fee payment to board member Frank Walsh for making introductions that ultimately led to the merger between the company and CIT Group, Inc. Belnick was excluded in the board discussion about the finder's fee, and was later instructed by board member Joshua Berman to dismiss Sullivan & Cromwell. See Rozen, *supra* note 217, at 70, 71.

443. See Fishman, *supra* note 22.

444. See Rozen, *supra* note 217, at 70.

445. See *id.*

446. See *id.* at 69.

And Belnick was excluded from key social events. He was not invited to the \$2.1 million lavish Roman orgy-themed birthday bash that Kozlowski hosted in the island of Sardinia for his new wife (at the company's expense).⁴⁴⁷ On numerous occasions, Belnick threatened to quit, but in the end he chose to stay.⁴⁴⁸

Like all inside counsel, Belnick was subject to intense obedience, alignment, and conformity pressures. As a subordinate reporting to Kozlowski and an agent to the de facto principal (Kozlowski), Belnick (perhaps reluctantly) accepted Kozlowski's framing of his roles and responsibilities, which included a lack of independent access to the board.

What might make inside counsel more than "mere employees" and not so aligned to the de facto principal? The answer is to simply change the structure so that inside counsel obeys a different master and accounts to a different principal. More specifically, my first proposal requires the boards of public companies to redirect the responsibilities over legal affairs from that of the senior officers to a committee of independent board members⁴⁴⁹ who may be organized as the audit committee or a separate QLCC.⁴⁵⁰ To minimize costs, the audit committee could double as the QLCC.⁴⁵¹ The committee's mission would include the oversight of legal compliance, the handling of all internal reports of evidence of material violations, and the ensuring of the quality of the company's legal resources. Accordingly, the committee would demand that the company's lawyers, both inside and outside counsel, inform directors of all material issues as they make corporate policy. This committee would make hiring and firing decisions, evaluations, and compensation determinations for the general counsel and would determine the budget for her department. This would be a dramatic change from the status quo, as boards generally play no role in the retention, evaluation, or compensation of counsel, apart from special circumstances,⁴⁵² or in legal compliance.

447. See *id.*; Anthony Lin, *A Cautionary Tale*, Corp. Counsel, Sept. 2004, at 1.

448. See Rozen, *supra* note 217, at 70, 74 (summarizing views on why Belnick chose to stay).

449. Independent board members are board members who are not employees of the company.

450. The gist of this suggested reform is favored by other academics. See, e.g., Campbell & Gaetke, *supra* note 130, at 42 ("The responsibility for the selection of the corporation's lawyer should be moved into the hands of a decision-maker that better represents the interests of shareholders. The most appropriate corporate decision-maker for that responsibility is the corporation's independent audit committee."); Fisch & Rosen, *supra* note 116, at 1136 (advocating a legal audit committee with similar objectives as a formal mechanism for empowering directors to obtain legal advice).

451. Another alternative would be to require audit committees or QLCCs to designate an outside lawyer or law firm as "general counsel" in the absence of inside counsel, although this alternative is less desirable due to law firms' lack of easy access to back-channel information. See *ABA Preliminary Report*, *supra* note 142, at 198-99 (suggesting that audit committees could designate outside general counsel).

452. Special circumstances include where counsel is retained to assist an independent board committee in connection with an independent investigation. Fisch & Rosen, *supra* note 116, at 1123.

The above reform could be accomplished through statute, an SEC regulation, or a stock exchange rule. To prevent circumvention of this reform by choosing not to hire inside lawyers, companies without general counsel (above a specified market capitalization) should be required to hire general counsel by the time they are subject to the reporting requirements of the Securities Exchange Act of 1934.⁴⁵³

My proposal sharply alters the inside counsel's ethical ecology. First, it redirects the obedience and self-interest pressures felt by inside counsel as "mere employees" of the company and subordinates to business management. Recall how Milgram's experiments suggested that we are all inclined to obey the commands of legitimate authority. By entrusting all authority⁴⁵⁴ over the legal department to the independent directors, the identity of the ultimate authority empowered to direct inside counsel would be changed. This should result in a subtle but perceptible change in the interaction between inside lawyers and managers. Inside lawyers should not view managers as bosses to be brazenly bypassed in order to make a report. Managers should not be seen as the main recipients of ingratiating overtures contrived to preserve inside lawyers' employment or to obtain good bonuses and promotions. While management would still be given deference on most business matters, management's authority on legal matters (which, of course, have business consequences) would be constrained, not only by the board, but also by inside counsel, who should be more comfortable in exercising their gatekeeping functions.

Second, my proposal mitigates the "faithful agent" pressures that cause lawyers to align their views and conduct with management's preferences. Recall the auditing vignettes study⁴⁵⁵ and similar research showing how we tend to align our views to those whom we are accountable. By changing the reporting relationships of the corporate legal department, we would be changing the audience to whom inside lawyers are generally accountable. This change should reduce the automatic tendency to conflate the corporate client with the senior officers whom inside lawyers have traditionally served. It should assist the lawyer in gaining psychological independence from those officers at the critical time when they act unlawfully and outside the scope of their authority. It should support the ability of the inside lawyer to determine when the specific co-agent no longer represents the corporation, and thus when the lawyer no longer owes the co-agent any duty.⁴⁵⁶ My proposal also remedies the disjuncture between the beneficiary of the lawyer's fiduciary duty (the corporation) and the lawyer's reporting

453. In the alternative, public companies without general counsel could be required to explain in public filings why they choose not to hire general counsel.

454. All authority includes the authority to hire, fire, determine salaries and bonuses, and determine budgets.

455. See *supra* notes 150-54 and accompanying text.

456. Gordon, *supra* note 176, at 1206.

duty (senior managers) to the extent that the independent board best represents the corporation's interest.⁴⁵⁷

Third, my proposal mitigates the "team player" pressures that can lead to organizational silence. Recall the organizational behavior literature that shows our strong tendency to stigmatize whistle-blowers as dissidents. A committee responsible for legal affairs that has an independent basis of power separate from the central chain of command⁴⁵⁸ can help to destigmatize internal whistle-blowing in two ways. First, proper implementation of this committee⁴⁵⁹ can ultimately regularize the communication of dissent as an important and normal duty of the employee to the corporation at large. This should in turn help to insulate such expressions from being perceived as "disruptive" or "insubordinate." Instead of being regarded as the ultimate act of betrayal, internal whistle-blowing could then be seen as a legitimate and loyal expression of corporate dissent. Second, it can serve as a "visible signal" and reminder "of the firm's attention to high ethical standards"⁴⁶⁰ and the firm's greater receptivity to whistle-blowing. The message to companies considering financing through the national securities markets would be clear: Once you have public shareholders, you owe a duty to your public investors to be truthful and follow the law.

Fourth, my proposal encourages inside lawyers (and outside lawyers) to report suspected misconduct to the board by, in effect, redefining the job of lawyers to include greater access to the board. By getting rid of the middleman (for example, the CEO), inside lawyers are more likely to report evidence of material violation to the board. Given the independent directors' committee's mission, meetings with the board (without the CEO's presence) should be a normal, although not necessarily frequent, occurrence. Familiarity with board members should increase the lawyer's comfort level in reporting a senior officer's actions and increase the likelihood that some back-channel information (often the kind that relates to

457. The incongruity between the inside lawyers' reporting and fiduciary duties will be reduced by more closely aligning both duties. This harmonization should lessen instances of conflict between the lawyer's imperative to obey superiors and her ethical duty to the corporation by making one body (the board) the beneficiary of both.

458. Miceli & Near, *supra* note 248, at 292; *see also* Callahan et al., *supra* note 367, at 204-05 (noting that the ombudsman approach is superior, because (1) existence of a centralized "channel for dissent encourages reports," (2) it is more straightforward because it obviates questions about the "identification of the appropriate supervisor to receive a report," (3) it "conveys a strong message" that it is open to dissent, and (4) it is "removed from the fray" (the central hierarchy)).

459. Of course, proper implementation is a tricky art, not a science. At minimum, the existence of this channel needs to be widely publicized, as do the clear reporting procedures. The employee also needs to be persuaded that there will be no retaliation for making internal reports. This can be done with clear prohibitions against retaliation and publicized accounts of punishment of retaliating managers. For suggestions for creating a climate conducive to internal whistle-blowing, *see, e.g.,* Miceli & Near, *supra* note 248, at 76-77.

460. Elizabeth Chambliss & David B. Wilkins, *Promoting Effective Ethical Infrastructure in Large Law Firms: A Call for Research and Reporting*, 30 Hofstra L. Rev. 691, 704 (2002).

corporate wrongdoing) would be conveyed to the board. This new reporting structure would also signal to outside lawyers the company's greater receptivity to negative information.⁴⁶¹ Just as important, the board would have access to a typically risk-averse voice through the general counsel⁴⁶² to counterbalance the sometimes optimistic or risk-preferring voice of the CEO.⁴⁶³ Since, as the recent scandals show, boards have been "kept in the dark [by the CEOs] about the company's . . . susceptibility to risk,"⁴⁶⁴ the general counsel's participation in the board's risk assessments should lead to enhanced decision quality by the board, given its consideration of multiple perspectives.⁴⁶⁵

Ineffectiveness objection. Why rely even further on independent directors (by requiring inside counsel to report to them) when they have recently proven impotent? Are not boards captured by the senior management they are supposed to monitor? Critics of my proposal might cite to the Enron board, which was an exemplary "board on paper, fourteen members [with] only two insiders."⁴⁶⁶ But this objection begs the question: How should "independence" be defined? And were Sarbanes-Oxley's narrow attempts to prevent the capture of the audit committee⁴⁶⁷ enough?

461. See Fisch & Rosen, *supra* note 116, at 1136.

462. See generally Donald C. Langevoort & Robert K. Rasmussen, *Skewing the Results: The Role of Lawyers in Transmitting Legal Rules*, 5 S. Cal. Interdisc. L.J. 375, 377-78 (1997) (predicting that the "systematic overstatement of risk is a robust, if not universal, phenomenon in the legal profession"). But see Richard W. Painter, *Lawyers' Rules, Auditors' Rules and the Psychology of Concealment*, 84 Minn. L. Rev. 1399, 1420-24 (2000) (using prospect theory to explain why lawyers may take unreasonable risks to conceal their own or their client's legal or ethical violations); Jeffrey J. Rachlinski, *Gains, Losses, and the Psychology of Litigation*, 70 S. Cal. L. Rev. 113, 173 (1996) (suggesting that loss-frame scenarios in litigation may trigger risk preference in lawyers).

463. Langevoort, *supra* note 36, at 288 (providing a more detailed discussion on traits, such as over-optimism, that are disproportionately represented in executive suites); Donald C. Langevoort, *The Organizational Psychology of Hyper-Competition: Corporate Irresponsibility and the Lessons of Enron*, 70 Geo. Wash. L. Rev. 968 (2002) (providing a neo-Darwinian explanation for why certain traits, such as optimism, overconfidence, and ethical plasticity, are selected in corporate promotions tournaments); Richard W. Painter, *Convergence and Competition in Rules Governing Lawyers and Auditors*, 29 J. Corp. L. 397, 402 n.19, 404 (2004) (positing that stock options may have increased managers' preference for risk, which preference is likely to be triggered in loss-frame scenarios).

464. Donald C. Langevoort, *Agency Law Inside the Corporation: Problems of Candor and Knowledge*, 71 U. Cin. L. Rev. 1187, 1207 (2003).

465. Morrison & Milliken, *supra* note 260, at 719 (citing M.E. Shaw, *Group Dynamics: The Psychology of Small Group Behavior* (1981)).

466. Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation*, 69 U. Chi. L. Rev. 1233, 1241 (2002). Also, the outside directors had relevant business experience, many with accounting backgrounds and prior senior management and board positions. But the Enron board's independence was seriously compromised by side payments and social ties.

467. The SEC adopted rules ensuring that audit committee directors are independent, focusing only on the issue of material economic benefits from the company. Excluded from the audit committee are individuals employed by or otherwise affiliated with the issuer or a subsidiary, or receiving consulting or other compensatory fees from the issuer (other than for director service). See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 301, 116 Stat. 745, 776 (codified as amended at 15 U.S.C. § 78j (Supp. II 2002)) (Standards for Audit

(The answer is no.) As the “ineffectiveness” objection suggests, in many companies, CEOs exercise enormous de facto power over their corporate boards.⁴⁶⁸ This “capture” is due to several reasons, including the outside directors’ almost exclusive reliance on senior managers for company-related information.⁴⁶⁹ Without more scrutinizing definitions of independence and reform of the director selection process, the problem of captured boards is likely to persist (despite my proposals).⁴⁷⁰ On the other hand, there is some evidence that firms with higher numbers of independent directors are less likely to commit financial fraud,⁴⁷¹ and that directors are

Committees); *see also* Standards Related to Listed Company Audit Committees, Securities Act Release No. 8220, Exchange Act Release No. 47,654, 79 SEC Docket 3736 (Apr. 25, 2003), *available at* <http://www.sec.gov/rules/final/33-8220.htm>. The New York Stock Exchange and Nasdaq have revised their listing standards to extend more exacting independence standards to a majority of the company’s directors. *See* SEC, NASD and NYSE Rulemaking: Relating to Corporate Governance, Exchange Act Release No. 48,745, 81 SEC Docket 2082 (Nov. 4, 2003), *available at* <http://www.sec.gov/rules/sro/34-48745.htm>.

468. *See, e.g.*, Victor Brudney, *The Independent Director—Heavenly City or Potemkin Village?*, 95 Harv. L. Rev. 597, 608-639 (1982) (noting limitations on independent directors’ ability to monitor management integrity and efficiency); James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, Law & Contemp. Probs., Summer 1985, at 83 (examining social psychological mechanisms that lead to independent directors insulating board colleagues from legal sanctions); Brian G. M. Main et al., *The CEO, the Board of Directors and Executive Compensation: Economic and Psychological Perspectives*, 4 Indus. & Corp. Change 293 (1995).

469. Lucian Arye Bebchuk et al., *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. Chi. L. Rev. 751, 772 (2002) (noting that the CEO controls much of the information that reaches the compensation committee); Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 Bus. Law. 921, 950-53 (1999) (noting that independent directors are “often ignorant about what is happening inside the company”); Brudney, *supra* note 468, at 609 n.37 (noting that, while the entire corporate hierarchy typically supports the efforts of management, boards generally do not have any staff devoted to their important activities); Langevoort, *supra* note 36, at 308 (noting that the CEO and senior managers are in control of the information flow to the board).

470. The persistence of the problem of captured boards means that inside counsel’s situational pressures will, too, persist.

471. Bhagat & Black, *supra* note 469, at 933 (positing, based on studies evaluated, that either “independent directors help to control financial fraud,” or “that managers who are prone to commit fraud resist oversight by independent boards”). *But see* Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 Yale L.J. 1521, 1533 (2005) (concluding that the literature on the composition of audit committees does not support the proposition that 100% independent audit committees will reduce financial statement wrongdoing). In response to Romano’s conclusion, I note that many of these studies have the irremediable flaw of having adopted cosmetic definitions of “independence” for directors, which is problematic, given the inherently flawed selection process of directors. *See id.* at 1531 (noting definitions of “independence” adopted). For a recent critique and reform proposal for the director selection process, *see* Michael B. Dorff, *Does One Hand Wash the Other? Testing the Managerial Power and Optimal Contracting Theories of Executive Compensation*, 30 J. Corp. L. 255 (2005). Also, some of the studies reviewed by Romano appear to support the proposition that completely independent audit committees do “improve performance,” although Romano dismisses them as “not a source for valid inferences because of methodological flaws.” Romano, *supra*, at 1532 n.27. In

generally unlikely to participate in fraud.⁴⁷² Many observers have also noted a trend in boards becoming more “active” and more powerful in the 1990s, as relative CEO power declined.⁴⁷³ And as the recent corporate scandals have shown, once boards confront blatant misconduct, they at least have the capacity to make the right decisions, which often include the immediate termination of misbehaving executives, financial restatements, and full public disclosure.⁴⁷⁴ Although reforms to mitigate board capture are beyond the scope of this Article, my reform assists by giving these directors direct access to inside counsel by reducing the information disparity between the board and the CEO. This access strengthens not only inside counsel’s hands, but the board’s as well.

Impracticability objection. Will not my proposal simply require too much of the independent directors’ time? This objection begs the question: Should directors spend more time on legal affairs? Certainly, my proposal questions the validity of the status quo. On average, directors spend about

addition, Romano admits that most of the studies reviewed relate to firm “performance” rather than financial statement misconduct, the latter (and not the former) being the relevant issue for Sarbanes-Oxley. *Id.* at 1530. Moreover, notwithstanding Romano’s conclusions, many of the studies Romano reviewed suggest that there is generally a positive correlation between a higher number of independent directors and less financial wrongdoing. See Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance* 12-102 (Yale Int’l Ctr. for Fin., Working Paper No. 04-37, 2004), available at <http://ssrn.com/abstract=596101>.

472. See Arlen & Carney, *supra* note 138, at 728, 729 (concluding that, based on the evidence, board involvement in frauds is unlikely).

473. See, e.g., Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 Vand. L. Rev. 1, 9 (2002) (noting several high-profile board revolts to support the observation that the board capture phenomenon is less valid today); Bebchuk et al., *supra* note 469, at 768 n.27, 773-74 (noting CEO tenure declines and more common CEO forced resignations as evidence of boards becoming more independent); Ira M. Millstein & Paul W. MacAvoy, *The Active Board of Directors and Performance of the Large Publicly Traded Corporation*, 98 Colum. L. Rev. 1283, 1285 (1998) (noting “[t]he evolution of boards [in the 1990s] from managerial rubber-stamps to active and independent monitors . . . [as a response to] performance problems associated with managerial entrenchment”).

474. Third and Final Report of Dick Thornburgh, Bankruptcy Court Examiner, at 297, *In re WorldCom, Inc.*, No. 02-13533 (Bankr. S.D.N.Y. Jan. 26, 2004), available at http://www.klng.com/files/tbl_s48News/PDFUpload307/10129/WorldCom_Report_final.pdf; *id.* at 260-61 (reaffirming conclusions that, while the Audit Committee failed to detect accounting fraud, such failures resulted from “deference that the Audit Committee showed to the Company’s former senior financial Management and the external auditor, rather than from any overt act or omission” and thus the Examiner “does not recommend that the Company consider any accounting-related claims against” them); see also Final Report of Neal Batson, Court-Appointed Examiner, app. D, at 46, *In re Enron Corp.*, No. 01-16034 (Bankr. S.D.N.Y. Nov. 4, 2003) (Role of Lay, Skilling, and Outside Directors), available at <http://www.enron.com/corp/por/examinerfinal.html>. The report concluded that the evidence reviewed was

not sufficient for a fact-finder to conclude that any of the Outside Directors failed to act in good faith, or that they acted with a conscious disregard for known risks. This is particularly true in an environment in which management often failed to provide the Board with meaningful information and even intentionally misled the Board from time to time.

Id.

180 hours per year on board business, including preparation and travel time.⁴⁷⁵ In contrast, managers work full-time for their companies. The vast discrepancy between managers and independent directors in the amount of time each group respectively devotes to a company's affairs "grants an enormous advantage to officers in any dispute between management and the board."⁴⁷⁶ The SEC has at least partially acknowledged that board members need to spend more time on legal affairs, as reflected in its adoption of an alternative QLCC reporting approach.⁴⁷⁷ And some scholars predict that the board will take on more responsibility for legal compliance.⁴⁷⁸ While achieving the optimal balance between board neglect and board micromanaging⁴⁷⁹ should be a challenge, I believe that the correct balance has not yet been struck for many companies. Obviously, this change in board responsibilities will have some cost consequences, but costs are not necessarily dispositive, and may be an appropriate trade-off for the company.⁴⁸⁰

475. Melvin Aron Eisenberg, *Corporations and Other Business Organizations* 156 (9th concise ed. 2005) (noting that outside directors spend about 180 hours per year, including preparation and travel time).

476. Michael Dorff, *Softening Pharaoh's Heart: Harnessing Altruistic Theory and Behavioral Law and Economics to Rein in Executive Salaries*, 51 *Buff. L. Rev.* 811, 851 (2003).

477. See *supra* notes 350-52 and accompanying text.

478. Langevoort, *supra* note 464, at 1202 (noting that the boards will take on more responsibility for legal compliance).

479. Let me clarify that I would not require the independent directors to micromanage legal affairs, which they understandably are reluctant to do if earnings results are good. The best analogy for the relationship between the general counsel and the independent directors is probably the relationship between the CEO and the board (not in terms of power, but in terms of the frequency and quality of interaction). Generally speaking, "the board's most important task is not business decision-making, but monitoring and supervision, most notably via the selection and compensation of the CEO." *Id.* at 1200. Management typically does not engage the board in day-to-day strategic business decisions. Similarly, the general counsel does not need to confer with the board on day-to-day legal decisions, but the board should establish a dialogue with her about her views of material legal risks. Many general counsels are comfortable in asserting their role in making day-to-day legal decisions in the best interests of the company. There will, of course, be times when consultation with the board or management is necessary, but this should not be unduly frequent.

480. As a result of increased board attention to legal matters, outside directors may need to whittle down the number of companies that they represent and, in turn, companies may need to jack up their compensation. This increase in director compensation can theoretically be offset by a decrease in CEO compensation, commensurate with a decrease in CEO's responsibilities. See, e.g., Martin Lipton & Stephen Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 *U. Chi. L. Rev.* 187, 246 (1991) (arguing for an increase in base compensation and a limitation in the number of boards that outside directors may represent as part of a general proposal for the quinquennial election of directors). Of course, many scholars question directors' abilities to rein in executive salaries. See, e.g., Bebchuk et al., *supra* note 469; Bhagat & Black, *supra* note 469, at 931 (reporting studies suggesting that executive compensation tends to be higher in firms with a high percentage of outside directors); Dorff, *supra* note 476. Admittedly, without additional reforms that reduce or eliminate the structural bias, high levels of director compensation may in fact compromise director independence, since CEOs, who currently exercise much influence over director selections in some firms, may be reluctant to renominate adversarial or scrutinizing directors. Gordon, *supra* note 466, at 1243. The issue of how to improve the

Circumvention objection. Cannot a “corrupt” manager simply circumvent inside counsel by not consulting her when choosing to engage in misconduct? While this certainly can happen, most significant frauds require substantial cooperation or acquiescence from inside lawyers.⁴⁸¹ Cannot the corrupt manager resort to retaining his own counsel and thus bypass the general counsel?⁴⁸² Given the structural nature of my reform, this should not be a major problem. Since the general counsel would report to the independent directors, it would be clear that the general counsel would be responsible for the retention of all counsel within the confines of the legal budget allocated by the independent board committee. Thus, a CEO’s defiance of this structure by hiring his own counsel would trigger a “red flag” for misconduct and could serve as insubordination grounds for terminating the CEO.⁴⁸³ Also, inside counsel’s easy access to back-channel information often means that, sooner or later, they are likely to learn of

board’s accountability (to the law or to shareholders) is beyond the scope of this Article, although it is, of course, entirely relevant to whether an inside attorney will report misconduct to the board in the first place (given the ex ante level of the board’s receptivity to such reports).

481. Burton & Dzienkowski, *supra* note 7, at 692-711; Koniak, *supra* note 337, at 195 (noting that “without lawyers, few corporate scandals would exist and fewer still would succeed long enough to cause any significant damage,” and discussing the involvement of several prominent lawyers and law firms in corporate scandals); Rhode & Baton, *supra* note 191, at 9 (discussing involvement by both in-house and outside counsel in the Enron scandal).

482. A corollary to this question is: “Can’t a clever manager resort to hiring ‘gray lawyers’ (who do not purport to be practicing law) from [a multidisciplinary practice “MDP”]?” For a definition of “gray lawyer,” see, e.g., Burnele V. Powell, *The Lesson of Enron for the Future of MDPs: Out of the Shadows and into the Sunlight*, 80 Wash. U. L.Q. 1291, 1301 (2002). To the extent that managers hire gray lawyers who can displace much of the consulting work typically performed by lawyers, Sarbanes-Oxley’s goals are impaired, as those critical gatekeeping duties are imposed only on licensed attorneys or those who hold themselves out as licensed attorneys. See 17 C.F.R. § 205.2(c) (2004) (defining “attorney”). On the other hand, these gray lawyers will also not be able to claim the attorney-client privilege over client communications, so there may be an offsetting disadvantage for managers to using them. This concern has been brought to the attention of the SEC. See Letter from Robert E. Rosen, Univ. of Miami Sch. of Law, to Jonathan G. Katz, Secretary, Sec. & Exch. Comm’n (Dec. 17, 2002), available at <http://www.sec.gov/rules/proposed/s74502/roosen1.htm> (calling for a more inclusive definition of “attorney” that would not increase the demand for firms of nonpracticing securities law consultants and would also include legally trained individuals who report to the CFO and not the CLO, e.g., tax managers who have legal backgrounds).

483. Of course, the language of the relevant employment contract needs to be scrutinized in order to complete this analysis.

misconduct.⁴⁸⁴ As noted earlier, knowledge of shaky accounting in Enron was widespread within the company and among inside lawyers.⁴⁸⁵

One final point bears mentioning. Much of the concern underlying the “circumvention” objection arises from the common assumption that errant corporate managers are blatantly corrupt and thus predisposed to “active” circumvention. But such a characterization presupposes venality—that these CEOs are, too, making explicit, conscious choices to sacrifice ethics for profit. While this may be true in some cases, most securities frauds committed by corporate managers may, in fact, be banal, where motivated reasoning, rather than any explicit calculation, is the driving mechanism.⁴⁸⁶ The same venality assumption underlies the fear that corrupt managers (or boards captured by corrupt managers) will resort to “opinion shopping,” the continued search by a determined wrongdoer for a compliant gatekeeper.⁴⁸⁷ Whether this is a realistic fear or not, with respect to auditors, solutions adopted to address this issue include the entrusting of the appointment of auditors to the audit committee of the board and the requirement of public disclosure when the company switches auditors. We should consider similar solutions with respect to the general counsel.⁴⁸⁸

484. See Coffee, *Attorney as Gatekeeper*, *supra* note 11, at 1308-09 (observing that many corporate actions require the participation of multiple individuals, which increases the likelihood that counsel will be aware of client misconduct). There are many ways inside counsel can learn of misconduct through the backchannel. For example, they can inadvertently hear a suspicious remark, they can be informed of the misconduct by an outraged employee, or a routine audit can uncover the fact that the CEO has retained a law firm without the permission of general counsel.

485. See *supra* Part II.A.3 (discussing a lawyer’s role as a “team player”); see also Dan Feldstein, *Skilling Says He Did No Wrong: Lawyer Told Not to Stick Neck Out*, Hous. Chron., Feb. 8, 2002, at 1A (describing what measures Enron’s inside attorney Jordan Mintz took when confronted with company fraud). Lisa Nicholson provides a detailed account of the knowledge of Enron’s in-house legal department about the accounting problems. See Nicholson, *supra* note 366, at 601-03; see also Batson Report Appendix C, *supra* note 3, at 190-202 (analyzing the role of Enron’s inside attorneys).

486. See Langevoort, *supra* note 280, at 139-41 (noting that securities fraud is often the result of simple recklessness born of self-serving, overly optimistic views of a firm’s prospects, which have little basis in reality, even though they are honestly held); Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. Corp. L. 1, 19-20 (2002) (noting that “the alleged perpetrators were not shady criminals but seemingly responsible business people” who were subject to judgment biases). But see, e.g., Mark Maremont, *Rite Aid Case Gives First View of Wave of Fraud on Trial*, Wall St. J., June 10, 2003, at A1 (describing the “great lengths” to which both the former CEO and the general counsel of Rite Aid went in order to “hide their tracks”).

487. See Gilson, *supra* note 80, at 911 (noting that the compliant gatekeeper might be required to agree up front to management’s position as a condition of engagement); Kraakman, *supra* note 11, at 72-74.

488. For example, the SEC could adopt a rule or regulation that requires disclosure as a “material event” on Form 8-K when the general counsel is terminated for a certain category of reasons. See *infra* Part IV.B (discussing whistle-blower protections).

B. *Whistle-Blower Protection*

At Tyco, Kozlowski's questioning of Belnick's loyalty in a discussion about the recall of the faulty sprinklers triggered an outpouring of frustration by Belnick. Belnick threatened to leave. Kozlowski warned that Belnick "would leave with nothing—no severance, no bonus. Belnick said he would sue and argue that he had been constructively fired because he was unable to do his job."⁴⁸⁹ Of course, Belnick probably did not know that his rights to sue his employer for constructive discharge would be quite limited.⁴⁹⁰

Unlike outside lawyers, inside lawyers may get into employment disputes with their client, sometimes leading to their discharge by a co-agent. While outside lawyers also may be terminated by their clients, rarely do such acts threaten their livelihood, as lawyers in private practice are typically diversified. Inside lawyers, on the other hand, may be faced with the dilemma of doing the right thing and losing one's job, or obeying one's boss and violating the law or other ethical mandates. The moral dilemma is exacerbated by the fact that, in many jurisdictions, inside lawyers have no legal redress against management retaliation.

The law of retaliatory discharge for inside counsel is a complicated patchwork of conflicting judicial and administrative decisions on the common law of retaliatory discharge and state professional ethics codes, and state and federal whistle-blower protection statutes, including Sarbanes-Oxley. The basic tension in these cases is between the conception of inside counsel primarily as an employee, deserving some judicial protection from retaliation, and as a lawyer-advocate, whose client has an unfettered right to terminate. Since the law in this area seems to be undergoing change, I will summarize the developments in some detail.⁴⁹¹

The first courts addressing this issue categorically denied inside counsel the common law right to sue under the tort of retaliatory discharge,⁴⁹²

489. See Rozen, *supra* note 217, at 70.

490. New York has refused to recognize a wrongful discharge claim for inside counsel. See *Wise v. Consol. Edison Co. of N.Y., Inc.*, 282 A.D.2d 335 (N.Y. App. Div. 2000) (holding that affirmative claims by in-house counsel against defendant employer "for damages, grounded in the theory of wrongful discharge, do not fall within the exception permitting an attorney to disclose confidences or secrets necessary to defend 'against an accusation of wrongful conduct'" (quoting Model Code of Prof'l Responsibility DR 4-101(c)(4) (1983))).

491. For good summaries of recent developments in this area, see 2 Villa, *supra* note 393, § 6.08; Lucian T. Pera, *Lawyers as Whistleblowers: The Emerging Law of Retaliatory Discharge of In-House Counsel* (Ass'n of Corporate Counsel 2005) (on file with author).

492. See Sally R. Weaver, *Client Confidences in Disputes Between In-House Attorneys and Their Employer-Clients: Much Ado About Nothing—Or Something?*, 30 U.C. Davis L. Rev. 483, 493-94 (1997) (noting that, in the prior decade, courts have issued twelve decisions that considered whether inside lawyers may state a claim for retaliatory discharge, but only three have recognized such a cause of action for inside lawyers). However, courts have been more willing to extend other statutorily protected rights to inside counsel. *Id.* at 492-93. For the proposition that inside counsel do not have a cause of action, see, e.g., *Willy v. Coastal Corp.*, 647 F. Supp. 116, 118 (S.D. Tex. 1986) (holding that the attorney asked to

which, for lay employees, would provide relief if the employee's retaliatory dismissal threatened public policy. These decisions are often grounded in the belief that attorneys do not need the additional incentive (as do other employees) to uphold the public interest that the tort of retaliatory discharge provides.⁴⁹³ These courts argue that the existence of a state professional ethics code, which clearly prescribes what an attorney must do in those situations, makes the tort superfluous for employed lawyers.⁴⁹⁴ The other major reason is that courts fear that the recognition of the tort of retaliatory discharge would significantly impair the special relationship of trust between attorneys and their de facto clients by chilling communications.⁴⁹⁵ Accordingly, inside lawyers' special role as lawyer-advocates supersedes their role as employees and, thus, being lawyer-advocates requires them to potentially sacrifice their economic livelihood in order to protect the "integrity of the legal profession."⁴⁹⁶

Fortunately for inside counsel, this harsh line is slowly giving way to a view that recognizes the situational constraints of their role as employees. These courts recognize an inside lawyer's limited right to sue under a tort of retaliatory discharge when acting under certain "public interest" concerns.⁴⁹⁷ These cases hold that a lawyer should be entitled to the rights

violate the law did not qualify for Texas's public policy exception), *rev'd in part on other grounds*, 855 F.2d 1160 (5th Cir. 1988), *aff'd*, 503 U.S. 131 (1992); *Balla v. Gambro, Inc.*, 584 N.E.2d 104, 107-08 (Ill. 1991) (holding that the attorney did not have cause of action against the employer for retaliatory discharge even where public safety was implicated); *Herbster v. N. Am. Co. for Life & Health Ins.*, 501 N.E.2d 343, 348 (Ill. App. Ct. 1986) (holding tort of retaliatory discharge was not available to general counsel working solely for a corporation and whose oral contract was terminable at will).

493. *Weaver*, *supra* note 492, at 494; *see, e.g., Gambro*, 584 N.E.2d at 109 ("In-house counsel do not have a choice of whether to follow their ethical obligations as attorneys licensed to practice law, or follow the illegal and unethical demands of their clients. In-house counsel must abide by the Rules of Professional Conduct.").

494. *Gambro*, 584 N.E.2d at 108 ("In this case, the public policy to be protected, that of protecting the lives and property of citizens, is adequately safeguarded without extending the tort of retaliatory discharge to in-house counsel.").

495. *Id.* at 110 ("If extending the tort of retaliatory discharge [to in-house counsel] might have a chilling effect on the communications between the employer/client and the in-house counsel, we believe that it is more wise to refrain from doing so.").

496. *Id.* ("[F]or all attorneys know or should know that at certain times in their professional career, they will have to forgo economic gains in order to protect the integrity of the legal profession.").

497. *See, e.g., Gen. Dynamics Corp. v. Superior Ct.*, 876 P.2d 487, 490 (Cal. 1994) (same); *GTE Prods. Corp. v. Stewart*, 653 N.E.2d 161, 166 (Mass. 1995) (permitting inside counsel to maintain an action for wrongful discharge in limited circumstances); *Parker v. M & T Chems., Inc.*, 566 A.2d 215, 222 (N.J. Super. Ct. App. Div. 1989) (holding that the New Jersey Conscientious Employee Protection Act was not inconsistent with the Code of Professional Ethics and that a wrongfully discharged attorney could recover monetary damages—as opposed to reinstatement—from a retaliating employer). The "public interest" standard varies somewhat. *See Allan Dinkoff, Analyzing the Attorney Whistleblower Claim: A Modest Suggestion for the Twenty-First Century*, in *Understanding Developments in Whistleblower Law 2 Years After Sarbanes-Oxley*, at 371, 378 (PLI Litig. & Admin. Practice, Course Handbook Series No. 6864, 2005). The *General Dynamics* court constrained the right to claims grounded in "explicit and unequivocal ethical norms

of a nonlawyer to sue where no sensitive confidentiality concerns are implicated or, if they exist, confidentiality can be adequately safeguarded through procedural devices, for example, in camera proceedings.⁴⁹⁸ While this departure from the traditional line is significant, the leading case representing this view makes it clear that where the claim cannot be pursued without breaching the attorney-client privilege the suit must be dismissed.⁴⁹⁹ As sternly warned by this court, “the in-house attorney who publicly exposes the client’s secrets will usually find no sanctuary in the courts.”⁵⁰⁰

More recently, a third line of cases, which began appearing in 2000, have gone even further and permitted inside counsel to reveal client confidences to the extent that they reasonably believe necessary to establish a retaliatory discharge claim.⁵⁰¹ These courts show sensitivity to the fact that inside counsel will have great difficulty pursuing any claim for retaliatory discharge without disclosing some attorney-client communications, given the role that inside lawyers play and the nature of the allegations inherent in a retaliatory discharge claim by employed lawyers.

Despite this emerging trend, many courts do not recognize this cause of action or have not had an opportunity to do so. Among those courts that do, many have not fully addressed the critical issue of whether inside counsel may use confidential or privileged information to pursue a claim. Of those that do, many neglect to distinguish the duty of confidentiality and the attorney-client privilege, which are two distinct concepts.⁵⁰² And only two judicial decisions to date have extended state statutory whistle-blower

embodied in the Rules of Professional Responsibility and statutes, and claims which are maintainable by the nonattorney employee.” 876 P.2d at 503 (emphasis omitted).

498. See *General Dynamics*, 876 P.2d at 503-04 (addressing confidentiality concerns). For criticism of the *General Dynamics* decision, see Weaver, *supra* note 492, at 502-06.

499. See *General Dynamics*, 876 P.2d at 503-04; *Meadows v. KinderCare Learning Ctrs., Inc.*, No. CV-03-1647, 2004 WL 1068793, at *5 (D. Or. May 11, 2004) (dismissing a claim of wrongful discharge brought by former inside counsel and stating that, since the claim was based on the attorney’s opposition to alleged discriminatory practices, it could not be proved without disclosing privileged communications which would violate public interest in maintaining client confidentiality).

500. *General Dynamics*, 876 P.2d at 503.

501. See, e.g., *Alexander v. Tandem Staffing Solutions, Inc.*, 881 So. 2d 607, 609 (Fla. Dist. Ct. App. 2004) (finding that the professional rules permit a petitioner to disclose client confidences to the extent reasonably necessary to make a claim against an employer-client under the Florida Whistleblower Act); *Burkhart v. Semitool, Inc.*, 5 P.3d 1031, 1041 (Mont. 2000) (holding that professional rules permit an attorney to reveal confidential attorney-client information “to the extent the lawyer reasonably believes necessary to establish an employment-related claim against” an employer-client); *Crews v. Buckman Labs. Int’l Inc.*, 78 S.W.3d 852, 866 (Tenn. 2002) (holding that “a lawyer may ethically disclose the employer’s confidences or secrets when the lawyer reasonably believes that such information is necessary to establish a claim against the employer”); *Spratley v. State Farm Mutual Auto. Ins. Co.*, 78 P.3d 603, 608 (Utah 2003) (holding that the professional rules permit attorneys to make disclosures reasonably necessary to establish a wrongful discharge claim against an employer-client).

502. See Pera, *supra* note 491, at 20-22.

protection specifically to inside counsel.⁵⁰³ Even if a state or federal whistle-blower protection statute is deemed to cover inside counsel, the inside lawyer may be prevented from pursuing the statutory claim due to confidentiality/privilege concerns. For example, in *Willy v. Coastal Corp.*,⁵⁰⁴ the first decision to address attorney-client privilege or confidentiality in a lawyer-as-whistle-blower case under a federal whistle-blower protection statute (in this case, environmental protection statutes), the U.S. Department of Labor's Administrative Review Board ("DOL") held that the discharged lawyer was not permitted, as a matter of federal common law, to use any privileged or confidential information of his former employer to prove his claim.

The *Willy* decision does not bode well for inside counsel seeking relief under the civil whistle-blower protection provision, section 806 of Sarbanes-Oxley. The DOL, which decided the *Willy* case, has jurisdiction over all Sarbanes-Oxley section 806 administrative complaints and should reach a similar result to that in *Willy*. However, there is potential for each federal circuit to reach a different conclusion at the appeals stage.⁵⁰⁵

What can be done to counteract self-preserving tendencies and encourage inside lawyers to take an ethical stand within their companies? First, Congress should clarify that the civil and criminal whistle-blower protection provisions of Sarbanes-Oxley sections 806 and 1107 also prohibit retaliation against inside counsel for reporting up the ladder. Congress should also make clear that inside counsel have a right to file a complaint under section 806 for retaliatory discharge.⁵⁰⁶ As noted above, the SEC's conspicuous failure to address this issue in the final implementing regulations promulgated under section 307, and the lack of clear legislative intent and clear language extending protection to inside counsel, are problematic in light of the *Willy* decision.

Of course, defining the right is not as simple as it sounds. Should this right be triggered only when the CEO or another officer with authority over counsel retaliates against inside counsel, or should it be triggered also in cases of board retaliation? Put differently, can the board ever terminate

503. See 2 Villa, *supra* note 393, § 6.11 (citing *Burkhart*, 5 P.3d at 1041; *Parker v. M & T Chems., Inc.* 566 A.2d 215, 222 (N.J. Super. Ct. App. Div. 1989)). The majority of whistle-blower statutes only apply to public sector whistle-blowers, and only a few extend protection to private sector whistle-blowers. *Id.*

504. See ARB Case No. 98-060, at 34-36 (U.S. Dep't of Labor Feb. 27, 2004), available at http://www.oalj.dol.gov/public/arb/decsn2/98_060a.caap.pdf (finding that in the absence of a claim that the company engaged in ongoing crime, fraud, or misconduct, or a claim that the attorney was fired for breaching a duty owed to the company as in-house counsel, as opposed to the employee, the attorney was precluded from using privileged material in order to establish his claim). In this case, the information and documents ultimately held privileged had already been introduced into evidence.

505. See Pera, *supra* note 491, at 24.

506. A whistle-blower may seek relief by filing a complaint with the Secretary of Labor within ninety days of the retaliatory act and may file suit in federal court if the Secretary does not issue a final decision within 180 days after the complaint is filed. 18 U.S.C.A. § 1514A(b)(1)(B), (b)(2)(D) (West Supp. 2005).

inside counsel (without liability) for taking a report of material violation up the ladder? What if the lawyer was mistaken but acted “reasonably”?⁵⁰⁷ What if the board reasonably and genuinely has lost confidence in counsel after counsel made a report in good faith? What if the board is “captured” by management or otherwise fails to exercise “due care”?

Raising these sticky issues is only meant to highlight the complexity of issues that are likely to arise, not to provide any magic answers. One could imagine, however, that these issues would be played out at trial and that different standards might apply, depending on which party was the retaliating actor.⁵⁰⁸ Perhaps a new “business judgment rule” would evolve to evaluate board actions for these types of cases. Perhaps a standard that is deferential to board action would develop, but the lawyer-claimant who makes a report in good faith and is terminated as a result could still be awarded, say, the present value of five years’ wages at the rate of payment prior to the retaliatory act.⁵⁰⁹ I mean only to point out that if we want inside lawyers to report matters up the ladder, we need to address the “threatened self-interest” that prevents her from doing so in the first place.

Second, the SEC should enact regulations or interpretive guidelines that clearly indicate that section 205.3(d), which permits disclosure of issuer’s confidences under certain circumstances, was intended to cover claims made by inside attorneys under a retaliatory discharge claim pursuant to section 806. In addition, state courts and state ethics oversight boards should conform their interpretation of state professional rules to the ABA ethics opinion⁵¹⁰ which interprets Model Rule 1.6(b)(2) as permitting an inside lawyer to disclose client confidences to the extent “the lawyer reasonably believes is necessary to establish her claim” of retaliatory discharge.⁵¹¹ As noted above, mere recognition of a cause of action under Sarbanes-Oxley section 806 is not enough. Even if courts granted a cause of action under Sarbanes-Oxley, the right is useless if inside attorneys are barred from disclosing client confidences in order to pursue their claims. As mentioned in Part III above, the current SEC regulation (section 205.3(d)) on disclosure of confidences does not indicate whether an inside lawyer can disclose a client’s or co-agent’s confidences in a retaliatory discharge case.

507. The statute protects the employee, so long as the employee “reasonably believes” the action in question to be a law violation. *Id.* § 1514A(a)(1).

508. *See, e.g.,* Dinkoff, *supra* note 497, at 378.

509. *Id.* This will allow counsel time to find work or, if that becomes unfeasible, to train in another field.

510. *See* ABA Comm. on Ethics and Prof’l Responsibility, Formal Op. 01-424 (2001) (“A Former In-House Lawyer May Pursue a Wrongful Discharge Claim Against Her Former Employer and Client as Long as Client Information Is Properly Protected”) (“We conclude that a retaliatory discharge claim or similar claim by an in-house lawyer against her employer is a ‘claim’ under Rule 1.6(b)(2).”).

511. *Id.* One should note that this opinion does not purport to address whether a cause of action for retaliatory discharge exists for inside counsel.

Third, to support these measures, the SEC should require companies to disclose voluntary or involuntary terminations of their general counsel based on professional reasons.⁵¹² This would parallel existing SEC rules requiring disclosure on Form 8-K for auditor terminations, which some have argued has historically been the best guarantor of an accounting firm's independence.⁵¹³ In the case of an actual auditor switch, an adverse market reaction typically follows.⁵¹⁴ While certainly such a notice to the public markets would have grave consequences,⁵¹⁵ the most likely and immediate effect would be to increase corporate compliance by increasing the cost of locating a "pliable gatekeeper."⁵¹⁶

These measures are critical to counteracting the enormous obedience, alignment, and self-interest pressures that arise from the fact that inside counsel are economically tied to a single client, as well as the reality that their career trajectory is under the control of the senior officer responsible for legal affairs. Inside counsel seem to recognize that taking an ethical stand seriously risks one's career. In a recent survey of inside counsel, "48 percent believed that establishment of laws protecting attorney whistleblowers" was necessary to ensure the well-being of the organizational client.⁵¹⁷

"Chilling communications" objection. But will not allowing disclosure of co-agent's confidences for retaliatory discharge claims lead to rampant lawyer whistle-blowing, the chilling of communications between the lawyer and co-agent, and—ironically—result in even less compliance with the law, because businesspeople would then be afraid to seek out legal advice?⁵¹⁸ A

512. In the SEC's second proposal, the issuer would have the burden of publicizing the attorney withdrawal. The idea of requiring the issuer to disclose on a Form 8-K was originally proposed by a commentator who reasoned that the disclosure would serve as a mechanism to ensure that investors would learn of possible misconduct within the company. See Fraidin & Mutterperl, *supra* note 384, at 655 n.203.

513. Gordon, *supra* note 466, at 1225 n.11 (noting that such auditor firing is a "high visibility sanction" that may ultimately cause more harm to officers and directors than to the accountants).

514. See James A. Yardley et al., *Supplier Behavior in the U.S. Audit Market*, 11 J. Acct. Literature 151 (1992) (noting that four studies report significant negative market reactions to auditor switches following disclosure of disagreements with auditors and/or receipt of a qualified opinion).

515. Letter from Anthony J. Horan, Corp. Sec'y, J.P. Morgan Chase, to Jonathan Katz, Sec'y, Sec. & Exch. Comm'n (Apr. 9, 2003), available at <http://www.sec.gov/rules/proposed/s74502/jpmorganchase040903.htm> (commenting on Securities Act Release No. 33-8185 and Securities Act Release No. 33-8186, and expressing concern that the immediacy of the company's required reporting actions, without the opportunity to investigate the matter fully, could have grave and unnecessary consequences for the investing community).

516. See Kraakman, *supra* note 11, at 72-74 (discussing the practice of shopping for compliant gatekeepers).

517. See Brown, *supra* note 148, at 97.

518. This "chilling communications" concern explained the ABA Task Force's withdrawal of the originally proposed mandatory "reporting out" (disclosure of client or constituent crime to a third party) provision of Model Rule 1.6. Hamermesh, *supra* note 356, at 39.

quick review of the arguments answering this objection suggests that the normative and empirical foundations of this objection are problematic at best.

First, this objection profoundly misunderstands the nature of modern corporate frauds, which require substantial cooperation or acquiescence from lawyers. As Susan Koniak notes, “[W]ithout lawyers, few corporate scandals would exist and fewer still would succeed long enough to cause any significant damage.”⁵¹⁹ Second, fears of “chilling,” or rampant whistle-blowing on the part of lawyers, are highly speculative.⁵²⁰ Third, this objection often assumes the myth that confidentiality is absolute, when in fact it is waivable by the entity, lasting only as long as it is in the entity’s interest.⁵²¹ Fourth, even assuming that there would be some chilling, the least desirable form of communication—advice to co-agents about how to avoid penalties for breaking the law—would most likely be threatened.⁵²² Fifth, this objection assumes that confidentiality is an end in itself, when the

519. Koniak, *supra* note 337, at 195 (discussing the involvement of several prominent lawyers and law firms in corporate scandals).

520. See Coffee, *Attorney as Gatekeeper*, *supra* note 11, at 1306-07 (noting that auditors have, on very few occasions, reported under their statutory obligation to report illegal acts under Section 10A of the Securities Exchange Act of 1934); Cramton et al., *supra* note 331, at 813, 816-17 (noting that there is no evidence that longstanding exceptions to confidentiality duty or attorney-client privilege have restrained the candor between co-agents and lawyers, and also noting that the incidence of lawyer whistle-blowing is “astonishingly low,” despite prevalent exceptions to the confidentiality duty); Hamermesh, *supra* note 356, at 50 (noting that the ABA Task Force was unable to discern any evidence of lack of candor or client reticence in the majority of states where older and permissive confidentiality rules prevailed); Elizabeth G. Thornburg, *Sanctifying Secrecy: The Mythology of the Corporate Attorney-Client Privilege*, 69 Notre Dame L. Rev. 157, 163-65 (1993) (summarizing studies on the effect of the attorney-client privilege on client communications); William H. Simon, *Ethical Discretion in Lawyering*, 101 Harv. L. Rev. 1083, 1142-43 (1988) (noting that the absence of an evidentiary privilege for accountants does not appear to drastically inhibit disclosure to them, and that even sophisticated people often volunteer self-inculpatory information to the police after *Miranda* warnings); Fred C. Zacharias, *Rethinking Confidentiality*, 74 Iowa L. Rev. 351, 377-96 (1989) (discussing the 1962 Yale study on the attorney-client privilege and reporting the results of the Tompkins County study, suggesting that some of the justifications offered for strict confidentiality are open to question).

521. See Cramton et al., *supra* note 331, at 813 (noting that confidentiality duty and privilege do not belong to agents and can be and are waived by future management and bankruptcy trustees); Thornburg, *supra* note 520, at 173 (noting that the privilege may be waived by the corporation without the participation of the employee whose communication is at issue).

522. See Coffee, *Gatekeeper Failure*, *supra* note 11, at 362 (analyzing Kaplow & Shavell’s arguments in the gatekeeper context); Louis Kaplow & Steven Shavell, *Legal Advice About Information to Present in Litigation: Its Effects and Social Desirability*, 102 Harv. L. Rev. 567 (1989) (analyzing the role of legal advice as a component of the sanctioning system and arguing that the case for protecting ex ante communications—when co-agents inquire about the law for purposes of complying with the law—is far stronger than the case for protecting ex post communications—when co-agents seek to avoid penalties for breaking the law).

ultimate goal of the law is to achieve compliance with the law, “not to maximize uninhibited communications between the attorney and client.”⁵²³

Finally, any potential chilling of communications would be offset by any benefits accruing to the organizational client in having an independent and empowered inside lawyer as a gatekeeper who is more likely to urge co-agents to follow the law and whose advice is more likely to be heeded.⁵²⁴ Moreover, as a normative matter, it seems perverse to care more about the candor of an irresponsible co-agent than averting the possible harm that might befall the organizational client, innocent third parties, shareholders, securities markets, or the legal system.⁵²⁵ Inside counsel seem to understand that there should be limits to the norm of confidentiality. In a recent survey, seventy-one percent of inside counsel supported sacrificing the attorney-client privilege to ensure the well-being of the organizational client.⁵²⁶

C. Compensation

To counter the prosecution’s attempt to characterize Belnick as having been bribed by Kozlowski with unauthorized loans and bonuses, the defense argued that Belnick’s lavish compensation was well earned. Belnick testified that Kozlowski told him at their first meeting that the pay at Tyco was “very generous,”⁵²⁷ and that Belnick had believed that Kozlowski, as Chairman, was fully authorized to set his salary without formal board ratification.⁵²⁸ Belnick testified that no Tyco director had ever asked him about his compensation, though “they most assuredly knew that [he] wasn’t working for free.”⁵²⁹ The defense argued that the \$17 million bonus, a crucial element in the prosecution’s case for venality, was not a bribe, but a reward for his triumphant handling of an SEC inquiry.⁵³⁰ Belnick also testified that he had believed Kozlowski’s assurances that he was eligible for the employee relocation loan program, adopted to assist employees moving from Tyco’s old New Hampshire offices to New York, even though Belnick’s old Paul, Weiss office was just a few blocks from his new Tyco office.⁵³¹ He testified that he had no intention of hiding his

523. Coffee, *Gatekeeper Failure*, *supra* note 11, at 361 (noting that the “norm of client confidentiality is a means to an end, not the end in itself”).

524. *Id.* at 363 (arguing that, even if it were true that clients would consult less, this impact could be more than fully offset by the fact that it would become more dangerous to disregard the lawyer’s advice under a “noisy withdrawal” regime).

525. Simon, *supra* note 520, at 1142.

526. See Brown, *supra* note 148, at 97.

527. Lin, *Belnick Testifies*, *supra* note 25, at 1.

528. *Id.*

529. See *id.*

530. Lin, *Trial Under Way*, *supra* note 25, at 1.

531. See Lin, *supra* note 447, at 1; Lin, *Trial Under Way*, *supra* note 25, at 1. Belnick received \$14 million in interest-free employee “relocation” loans to renovate a \$2.8 million Manhattan apartment and buy a \$10 million luxury home in Park City, Utah (where Tyco had no office). See Bilodeau, *supra* note 33.

lavish bonuses and loans, but merely deferred to CFO Swartz on whether he needed to disclose them on questionnaires used to prepare the company's proxy statements.⁵³²

One of the most eyebrow-raising aspects of Belnick's compensation was that his annual bonus was set at one-third of Kozlowski's.⁵³³ Such a mutual linking of fortunes can create a serious conflict of interest. As expert witness Professor Thomas L. Hazen testified during the trial, "The company, not the chief executive, is the general counsel's client."⁵³⁴ A linked bonus puts tremendous economic pressure on the general counsel to simply do what the CEO wants, which may contravene what is best for the company. In other words, a linked bonus will contribute to obedience and alignment pressures.

But the general counsel does not need the extra situational pressure of a linked bonus to obey or align with management. Part II above argues that two modern corporate compensation practices exacerbate situational pressures.⁵³⁵ First, subjectively appraised bonuses, which are a growing component of total compensation, create substantial obedience and alignment pressures. Second, the practice of incentives-based equity compensation for inside lawyers subjects them to additional self-interest pressures that, through motivated reasoning, may constrain their ability to carry out their fiduciary duty to the organizational client. On top of those pressures is the hard reality that inside counsel, unlike their outside counterparts, are completely economically dependent on their sole client.

What can be done to reassure the threatened self-interest? First, as part of "best practices," corporate boards should reduce the subjective component of an inside lawyer's compensation package. Instead of a large discretionary bonus that would be awarded to the inside lawyer upon the completion of the fiscal year and the satisfaction of her boss, she should receive a higher base salary and a smaller bonus. Coupled with a change in reporting to a committee of independent board members, this different allocation should mitigate the pressures to obey and align herself with management.

Second, the SEC, state courts, and state ethics oversight boards should pass rules that would restrict ex ante the amount of equity investments that a lawyer may accept as compensation. In the alternative, these regulatory authorities could permit boards to replace the lawyers' stock options with a grant of shares that do not vest until six months after the lawyer's employment is terminated (voluntarily or involuntarily), or the vesting

532. See Lin, *Belnick Testifies*, *supra* note 25 (noting Belnick's testimony that Tyco had entrusted disclosure issues to the financial rather than the legal department).

533. Jonathan D. Glater, *Lawyer Caught in Tyco Tangle Leaves Friends Wondering*, N.Y. Times, Sept. 24, 2002, at C1 (noting that, under a second contract, Belnick's bonus would be no less than one-third of that received by Kozlowski); see also Alexei Oreskovic, *Next in Line for Scrutiny: GC Salaries*, Nat'l L. J., June 14, 2004, at 1.

534. Oreskovic, *supra* note 531, at 1.

535. See *supra* Part II.A.1.b.

could be accelerated upon termination. These measures should mitigate self-interest pressures that arise from compensation being tied to the company's stock price, and should lessen the temptation to acquiesce in the aggressive earnings management practices of senior officers.⁵³⁶ While these may sound like radical measures, the traditional view in the legal profession until the late 1990s was that lawyer equity investments in clients should generally be avoided.⁵³⁷

D. Ethical Norms

Testifying in his own defense, Belnick described his struggle to carve out a role for himself in his new company. Belnick said that CFO Swartz was lionized in the company as a financial whiz and that Swartz and the finance department, not the legal department, were in charge of securities filings. Thus, Belnick did not second-guess Swartz's assurances on disclosure or employee loan eligibility matters. Prosecutor John Moscow repeatedly asked Belnick why he had not sought advice from outside lawyers on a number of "red flag" issues. He challenged Belnick on whether he had familiarized himself with the corporate bylaws, board meeting minutes, and actual terms of the various loan programs. Belnick responded indignantly, stating that he "did not go on an archeology expedition backward into Tyco history."⁵³⁸

As discussed in Part II, Belnick, like all employees, struggled with persistent conformity pressures to be a "team player." Although Belnick appeared to have difficulty fitting in with the Tyco crowd, he understood well one of the sacred rules of conformity in many companies: Do not make waves.

Conformity pressures are especially difficult to deal with, because they arise from the mere fact of being surrounded by peers, which one cannot avoid in any institutional setting. Thus, I advance only a tentative solution to the problem of conformity pressures. While creating a corporate environment that regularizes the act of dissent should mitigate pressures to conform, the most effective way to lessen the impact of conformity pressures is to counteract them with competing conformity pressures from another social network. Active participation in bar-sponsored continuing legal education ("CLE") programs that allow open discussion of ethical issues facing inside counsel should help. To have the desired effect, these programs should be based on the Alcoholics Anonymous model, which relies heavily on "positive" conformity pressures that induce the participant

536. Alexei Oreskovic, *Counsel in Spotlight*, Legal Times, June 21, 2004, at 1 (discussing proposals for setting the compensation for compliance officers).

537. Dzienkowski & Peroni, *supra* note 132, at 412.

538. Lin, *supra* note 447, at 1.

to make the morally correct choice. Conventional forms of ethics training produce limited evidence of changing behavior.⁵³⁹

Of course, all lawyers, especially inside lawyers, have a problem with the duty of confidentiality. However, unlike lawyers at law firms, inside counsel cannot camouflage a reference by alluding to “one client of mine.”⁵⁴⁰ The inside lawyer is thus left with three unpalatable options. First, assuming she has the requisite client authorization or approval to do so, she may hire a law firm to provide legal advice on her ethical obligations. But, depending on the nature of the ethical issue,⁵⁴¹ she may need to obtain a conflicts waiver from the law firm, which may be impracticable. Moreover, the law firm’s loyalty would necessarily run to the organization that retained it. Second, she may also consult with other inside lawyers in her department, but she must be aware that such consultations may not be confidential if the other inside lawyers conclude that her interests are potentially adverse to the interests of the organization. Third, she could also hire her own personal lawyer, which may be an impracticable financial burden.⁵⁴²

One possible solution to the problem of confidentiality would be to allow pseudonymous participants to discuss their ethical dilemmas through computer-mediated communications, such as Internet chat rooms and virtual social worlds.⁵⁴³ Although this possibility seems outlandish now, consider the fact that lawyers already chat pseudonymously on blogs and bulletin boards in communities such as “greedy associates,”⁵⁴⁴ exchanging all kinds of confidential information. Within our lifetimes, we will see ever increasing amounts of social interaction mediated through online communities, many of them represented by immersive graphical environments. This provides at least the possibility of serious, repeat-play social interactions with fellow (but pseudonymous) attorneys in a specific bar-sanctioned CLE environment that encourages ethical behavior. This would create a sort of “ethical team” pressure counter to that of the firm. If certain legal tweaks (for example, an expansive interpretation of Model

539. Joseph L. Badaracco & Allen P. Webb, *Business Ethics: A View from the Trenches*, 37 Cal. Mgmt. Rev. 8 (1995).

540. 1 Villa, *supra* note 393, § 3.35 (noting that, by virtue of the inside lawyer’s position, confidentiality is easily breached when an inside lawyer informally consults with another member of the bar).

541. If the inside lawyer is seeking advice regarding her rights vis-à-vis her employer’s, the inside lawyer’s interest could be construed as being adverse to the organization’s and, thus, a conflict of interest waiver would be necessary.

542. Also, bar associations provide opinions on ethical issues raised by anonymous lawyers. Unfortunately, the process can take months, and most ethical issues are time-sensitive. 1 Villa, *supra* note 393, § 3.35 n.1.1.

543. Another commentator has also suggested using the Internet. *See id.* § 3.35.

544. This website had been used as a forum for law firm associates to trade salary and bonus information, but now also lists job openings, among other things. *See* <http://www.greedyassociates.com> (last visited Nov. 4, 2005).

Rule 1.6(b)(4))⁵⁴⁵ that help reinforce the pseudonymity of the communications are required,⁵⁴⁶ they would not be difficult to create and implement.

To be clear, I am not calling for legal interventions to mitigate conformity pressures. Rather, I am acknowledging that any effective reform of lawyer conduct probably needs to be accompanied by a reform of attendant ethical norms.

Impossibility objection. Skeptics will say that pressures to conform to peers can never be completely eliminated. As I acknowledged above, this is probably correct. But this should reassure those who fear that my proposals would create rampant whistle-blowing. The concern is that an ambitious, overeducated, newly empowered, and more independent inside lawyer will become unduly confrontational and uncooperative, making frequent and unnecessary reports (“false alarms”) to the board. For many, this would be disastrous to the efficient functioning of the public company. But I believe that this scenario is very unlikely, precisely because there is no way to eliminate conformity pressures. Pressures to be a “team player,” despite all of my reforms, will remain and persist substantially. To the extent that these pressures will reduce the likelihood of opportunistic and overly aggressive inside lawyer conduct, conformity pressures can be good.

CONCLUSION

On the fifth day of jury deliberations, Belnick’s defense counsel Reid Weingarten met in the prosecutor’s conference room to iron out the last few details of the plea bargain. The District Attorney John Moscow was prepared to drop all felony charges against Belnick. Instead of twenty-five years in state prison, Belnick would risk none and plead guilty to one misdemeanor. Plus—as a sweetener—the District Attorney’s office would use its influence to settle civil suits brought by the SEC and by Tyco.⁵⁴⁷

But then applause erupted from the courtroom, signaling that the jury had finally reached a verdict.⁵⁴⁸ The plea deal was still on the table: Belnick could take it and never hear the verdict. “Do we have a deal?” Moscow anxiously asked.⁵⁴⁹ Weingarten’s cell phone rang. It was Belnick, who was screaming, “Whatever you’re doing, stop.” “We’re taking the verdict, we’re taking the *fucking* verdict!” Weingarten was surprised Belnick was putting 25 years in prison back on the table.”⁵⁵⁰

545. This rule is an exception to the rule of confidentiality, where confidences may be disclosed “to secure legal advice about the lawyer’s compliance with these Rules.” Model Rules of Prof’l Conduct R. 1.6(b)(4) (2004).

546. One might, for instance, be concerned about firms trying to determine the true identity by subpoenaing relevant Internet Service Providers or virtual community firms. Compare the music industry’s attempt to discover the identity of file sharers.

547. See Fishman, *supra* note 22.

548. *Id.*

549. *Id.*

550. *Id.*

As the foreman rose to announce the verdict, “Belnick crossed himself, turned to his wife and mouthed, ‘I love you.’ Three Paul, Weiss lawyers sobbed as the foreman said ‘not guilty’ to each count.” Belnick hugged everyone, sobbing and shouting, “‘For two years, what they did to me!’”⁵⁵¹

While the jury sympathized with the prosecution’s story that Belnick should have had a more vigilant presence, they felt that reasonable doubt favored Belnick. “He didn’t hold up his fiduciary responsibilities to the shareholders,” one juror said. But “[e]verything that he got was documented through e-mails and memos with the company’s signature,” said another juror. “The evidence we had satisfied us that he got it the right way.”⁵⁵² The jurors seemed satisfied that Belnick received his bonuses and lucrative benefits through ordinary means: His boss simply gave them to him. The situation seemed actually quite banal.

Regardless of Belnick’s actual guilt or innocence, this case vividly illustrates the underlying importance of situational factors: Who you report to, who you are paid by, and how you are paid matters. This is something that the Belnick jurors—employees subject to obedience, self-interest, alignment, and conformity pressures—must have identified with and understood in granting their acquittal. Perhaps, also, the jurors saw past the excessive sums of money given to Belnick and ultimately acknowledged how consistently Belnick acted with what many (especially many lawyers) consider is the appropriate, morally detached role of lawyers.

While the solution proposed by this Article is not a panacea for all corporate malfeasance,⁵⁵³ it is based on a more adequate model of fraud, one that takes into account the situational pressures of a general counsel like Belnick. This model is not built on the premise that a person’s unethical actions are typically the product of a cold and careful weighing of alternatives, or that only certain aberrant individuals are predisposed to succumb to infectious greed.⁵⁵⁴

551. *Id.*

552. *Id.*

553. Specifically, I do not generally address the malfeasance of senior managers, nor do I engage in the broader debate about how best to provide incentives for organizations to care about the law, although that issue is clearly relevant to whether the board will be receptive ex ante to a report of evidence of a material violation or will reject the bad news and “shoot the messenger.” See, e.g., Deborah A. DeMott, *Organizational Incentives to Care About the Law*, *Law & Contemp. Probs.*, Autumn 1997, at 39 (providing a cogent defense of vicarious liability for criminal acts); Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 *Wash. U. L.Q.* 487 (2003) (criticizing mitigation of penalties for firms with “internal compliance structures”); Kimberly D. Krawiec, *Organizational Misconduct: Beyond the Principal-Agent Model*, 32 *Fl. St. U. L. Rev.* 571 (2005) (criticizing the U.S. legal system’s move toward duty-based organizational liability as a means for deterring organizational misconduct).

554. I share the view of Milton Regan who notes, “We need to move beyond the claim that unethical behavior is attributable mainly to a decline in the personal morality of lawyers or the integrity of law firms—and that this results from the change in law practice from a profession to a business. See Milton C. Regan Jr., *Eat What You Kill: The Fall of a Wall Street Lawyer* 6 (2004).

Although the context is in many respects incomparable, the basic sentiment of Hannah Arendt in her famous account of the trial of Nazi Adolf Eichmann captures the insight that the causal forces behind a person's actions are often better explained by looking at that person's role in the organization (in Eichmann's case, an opportunistic bureaucrat) rather than their psychiatric record:

The trouble with Eichmann was precisely that so many were like him, and that the many were neither perverted nor sadistic, that they were, and still are, terribly and terrifyingly normal.

. . . Eichmann was not Iago and not Macbeth . . . Except for an extraordinary diligence in looking out for his personal advancement, he had not motives at all . . . He *merely*, to put the matter colloquially, *never realized what he was doing*.⁵⁵⁵

Eichmann was operating in accordance with and within the boundaries set by prevailing social norms of Germany at the time. Any solution to the problem of lawyer acquiescence in fraud must also take into account the prevailing ethical norms and role ideologies of lawyers.

Although many are quick to point out that inside lawyers simply do not wish to monitor their business brethren and resent the imposition of any gatekeeping duties, I believe that many inside lawyers (and lawyers generally) hunger to be more ethical and want independence from the demands of senior management.⁵⁵⁶ But until that time comes, inside counsel must continue to grapple with their gatekeeping duties and their overwhelming situational pressures.

"This is a brave new world. You used to become a general counsel because you wanted to watch your kids play soccer," said Weingarten, referring to the stereotype of in-house lawyers as quality-of-life refugees from firm jobs. Now, he says, "it's become the hardest job, the most dangerous place to be."⁵⁵⁷

555. See Arendt, *supra* note *, at 276, 287.

556. See Brown, *supra* note 148, at 96-97 (noting that an overwhelming majority of in-house counsel want an expanded role in preventing and reporting fraud, with greater access to the CEO and the board).

557. Lin, *supra* note 447, at 1.